

The Need to Revisit Ability-to-Pay Principle in the Ethiopian Employment Income Tax System[→]

Endryas Tekalegn^Σ & Fassil Wodwossen^π

Abstract

The application of the ability-to-pay principle in a given country supports the realization of a fair tax system and the protection of the basic rights of taxpayers. However, the application of the principle remains unclear in the Ethiopian employment income tax system. This article, through qualitative, comparative, and doctrinal research tools, tried to assess the application of the ability-to-pay principle under the income tax legal regime and its role in contributing to poverty reduction efforts in Ethiopia and to the protection of human rights. The result reveals that the Ethiopian employment income tax structure neglects the personal and family status of the taxpayer, the number of dependents and disability, thereby causing employees to pay the highest price as a result of the ever-increasing cost of living. This raises the need to reconsider the tax policy and amendment of the income tax laws in such a way it ensures tax payment based on the ability-to-pay and assist employees fulfil their basic needs.

Keywords: Ability-to-pay; Employment Income Tax; Poverty Reduction.

Introduction

[→] This article is the result of a research-project funded by USAID's Fete (Justice) Activity in Ethiopia. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID.

^Σ LL.B, LL.M, PhD Candidate, Lecturer of law, Dire Dawa University, Advocate and Attorney at-Law in all Federal Courts.

^π LL.B, LL.M, Lecturer of law, Dire Dawa University, Advocate and Attorney at-Law in all Federal Courts.

Ethiopia is one of the fastest-growing economies today, registering an annual economic growth rate of 9.5 % over the past 15 years.¹ Despite this, a number of key economic challenges remain unsolved including the high cost of living, inflation, and inequality. The tax policy is one of the key tools to manage economic challenges including fair wealth redistribution and poverty reduction.² If policymakers are committed to ending poverty and improving the lives of their poorest citizens, they need to explore ways to redesign taxation and transfers so that the poor-especially the extremely poor-do not end up paying more than their fair share without reaping the benefits.³

The government of Ethiopia introduced ‘Home-grown Economic Reform’ in 2019 which aims to address these issues by implementing a new set of comprehensive reforms.⁴ In June 2020, the government has also introduced a new 10-year development plan under the theme of ‘Ethiopia: An African Beacon of Prosperity’ for the years 2020/21 to 2030/31.⁵ The Plan aims to reduce the poverty rate from 19% in 2020 to 7% by 2030.⁶ Thus, realizing

¹World Bank Report (fact sheet), Available at: <https://www.worldbank.org/en/country/ethiopia/overview> (Last Accessed on April 2, 2022).

² Jorge Martinez-Vazque, Violeta Vulovic, and Blanca Moreno Dodson, The impact of Tax and Expenditure Policies on Income Distribution: Evidence from a Large Panel of Countries. *Review of Public Economics*, Vol. 200, No.1, (2012), p.98.

³ Gabriela Inchauste and Nora Lusting, How Do Taxes and Transfers Impact Poverty and Inequality in Developing Countries, *World Bank Blogs*, (September 18, 2017), available at: <https://blogs.worldbank.org/developmenttalk/how-do-taxes-and-transfers-impact-poverty-and-inequality-developing-countries> (Last Accessed on July 1, 2021).

⁴ International Monetary Fund, Six Things to Know About Ethiopia’s New Program, (December 23, 2019), Available at: <https://www.imf.org/en/News/Articles/2019/12/23/na122319-six-things-to-know-about-ethiopias-new%20program> (Last Accessed on July 1, 2021).

⁵ Harris Tom and Seid Edris Hussein, 2019/2020 Survey of the Ethiopian Tax System, *IFS Report*, No. R187, (2021), P. 15, Available at: <https://www.econstor.eu/handle/10419/235073> (Last Accessed on July 2, 2021).

⁶ Federal Democratic Republic of Ethiopia Planning and Development Commission, Ethiopia 2030: The Path way to Prosperity: Ten Years Perspective Development Plan (2021-2030), P. 27, available at: <https://europa.eu/capacity4dev/file/109230/download?token=rxippQKh> (Last Accessed on July 3, 2021).

this requires sustained improvements in domestic resource mobilization and proper income redistribution to ensure that the poorest and most vulnerable members of the population are also able to enjoy the benefits of continued economic growth.⁷

High inflation and the hike in food price, house rent, fuel price, etc. have always been the news and the moaning of employees. The tax burden effect on the living standard of employees is directly related to human rights which most tax policies shadow.⁸ Employees with low-income levels suffer and fight for survival reflecting the direct impact on civil, social, and economic rights.⁹ For example, the right to life, the right to property, and new generic rights like the right to sustainable development and such problems for certainty will be alleviated by improving taxation system with practical actions of levying tax on the consideration of ability-to-pay.

Accordingly, the primary goal of the Ethiopian tax law and policy should not only be raising revenue but also attaining equity among taxpayers as part of the move to modernize the tax system.¹⁰ Equity primarily ascertains that taxpayers pay the tax in consideration of their ability-to-pay under different vertical schedules.¹¹ Thus, the ability-to-pay principle is fetched from the equity principle, which is the paradigm pillar in taxation.¹² The approach is a

⁷ Anthony B. Atkinson, Chrysa Leventi, Brian Nolan, Holly Sutherland and Iva Tasseva, Reducing Poverty and Inequality Through Tax-Benefit Reform and the Minimum Wage: The UK as a Case-Study, *Journal of Economic Inequality*, Vol. 15: No.4, (2017), P. 305.

⁸ Alejandra Mancilla, The human right to subsistence, University of Oslo, (2019), P. 2, Available at <https://onlinelibrary.wiley.com/doi/abs/10.1111/phc3.12618> (Last accessed on July 4, 2021)

⁹ Anastasija Jersova and Inta Kotane, The Impact Of the Labour Tax Burden On the Living Standard of the Inhabitants of Latvia, *Journal of Regional Economic and Social Development*, Vol.12: No.1, (2020), P.98.

¹⁰ Harris and Seid, *supra* note 5.

¹¹ Michael L. Goetz, Tax avoidance, horizontal equity, and tax reform: a proposed synthesis, *Southern Economic Journal*, 798-812, (1978), P.807.

¹² Orhan Sener, Principles of taxation, *Maliye Araştırma Merkezi Konferansları*, Vol.37, (1998), P. 83; See also Chauke K. R, Sebola M. P, and Mathebulu N. E, Reflection on

progressive realization and exemption of the minimum threshold from tax and sometimes introducing exemptions or deductions.¹³

This article, therefore, examines the application of the ability-to-pay principle in the employment income tax laws of Ethiopia and its contribution to poverty reduction efforts in the country. Methodologically, it uses doctrinal, qualitative and comparative research methods. As such, it analyses different laws including the FDRE constitution, scholarly commentaries, and other international legal instruments to which Ethiopia is a member. Primary data is collected via interview. It also employs a comparative analysis with the view that the growing interaction of experiences among the legal systems results from plurality which helps to draw lessons from other countries.

The paper is organized into four Parts. Part one explains the conceptual underpinnings of the ability-to-pay principle. It explains the principle of the ability-to-pay, and the justifications underlying it. Also it discusses the nexus between ability-to-pay, taxation, and human rights. Part two explores experiences of other countries such as France, United Kingdom, Ghana, and Kenya. The third section discusses the role of applying the ability-to-pay principle in employment tax laws of Ethiopia in reducing poverty. In this part, the legal and policy framework of Ethiopian income tax laws towards the ability-to-pay principle is examined. Part four, finally, provides a concluding remark and suggests the way forward.

1. Taxation, Ability-to-pay Principle and Human Rights

1.1. Conceptualizing the Ability-to-pay Principle

The divergent positions on what constitutes ability have given rise to a number of theories. The most widely known and most supported justification

the ability to pay theory of taxation in the context of South African Municipalities. International Conference on Public Administration and Development Alternatives *IPADA*, (2017), P. 403.

¹³ Atkinson et al, *supra* Note 7.

for ability-to-pay is founded on grounds of sacrifice.¹⁴ Tax payment is perceived as a deprivation to the taxpayers since it results in a surrender of money that could be used for personal purposes to the government in return of none quid pro quo benefits. It should be noted here that payment of tax is not for rejoicing as taxation is a sacrifice to the taxpayers. Rather, the absence of direct quid pro quo, as in trade, may account for the feeling of deprivation that the taxpayer experiences.¹⁵ Since tax payment instils a direct and immediate feeling of loss on the taxpayer, he/she may strive to avoid it by one means or another. In so doing, for achieving Ability-to-pay, John Stuart Mill points out that the burdens on taxpayers should be designed so that each taxpayer contributes an equal sacrifice.¹⁶

Thus, a person who is over-taxed relative to others of the same status bears a sacrifice. Poor people who pay tax on the necessities of their existence clearly make a sacrifice to effect this payment. So, in assessing the equity of a tax distribution, what matters is not the sum of money paid by the taxpayer in itself, but his loss of well-being.¹⁷ In other words, the size of the sacrifice depends not just on the amount of tax payments, but also on his income and other circumstances that might influence the impact of the fiscal duties on the well-being of a person, reducing the degree of private satisfaction of needs that he can achieve.¹⁸ Such circumstances include also those related to the

¹⁴ Clara Maria Grassi, Status and Impact of the Ability to Pay Principle in the ECJ's Case Law Concerning Tax Benefits Based on Personal and Family Circumstances, Master's Thesis, *University of Lund*, (2015), P. 16.

¹⁵ Stephen Utz, Ability to Pay, *Whittier Law Review*, Vol.23, No.4, (2001), P.867- 950.

¹⁶ Mill, J. S., Principles of political economy. In *The Economics of Population* (pp. 97-104). Routledge. Cited in Pressman Michael, the Ability to Pay in Tax Law: Clarifying the Concept's Egalitarian and Utilitarian Justifications and the Interactions between the Two: *NYUJ Legis. & Pub. Pol'y*, 21, 141, (2018), P.150; Scott H. Gibson, A Critical Analysis of the Ability to Pay: *Edinburgh Student L. Rev.*, 1, 1, (2009). P 18

¹⁷ Tapan Mitra and Efe A. Ok, Personal Income Taxation and the Principle of Equal Sacrifice Revisited, *International Economic Review*, Vol. 37: No.4, (1996), P.925.

¹⁸ Henry Sedgwick Quoted in Tapan Mitra and Efe A. Ok, Personal Income Taxation and the Principle of Equal Sacrifice Revisited, *International Economic Review*, Vol. 37: No.4, (1996), P.925.

taxpayer's personal and family situation (as, for instance, the burden to provide for his or her family).¹⁹

1.2. Foundations of the Principle of Ability-to-pay

The justification and legal basis of the principle of ability-to-pay is found in a number of other grand principles. These include equity and fairness, equality, and the right to have a standard of living.

i. Equity and Fairness

From Greek philosophers such as Aristotle and Plato who initially developed the concept of fairness as justice up to the Universal Declaration of Human Rights (hereinafter UDHR), one can trace continual efforts to claim fairness for each citizen defined in broader and more inclusive terms over time.²⁰ For instance, the first legal formulation of the ability-to-pay principle came with the Declaration of the Rights of Man approved by the National Assembly of France (August 26, 1789). Article 13 states that all citizens should contribute in proportion to their means.²¹ Consequently, equity and fairness then became the most basic set of principles applied to constitutions and laws in the world and become general principles of law.²² Thus, tax equity is the distribution of burdens among taxpayers in a manner regarded as fair. In that sense, the ability-to-pay is a key factor underlying a system for distributing the costs of government in a way that promotes fairness. This is because when we say a

¹⁹ Id.

²⁰ César Augusto DOMÍNGUEZ CRESPO, The “Ability to Pay” as a Fundamental Right: Rethinking The Foundations of Tax Law, *Mexican Law Review*, Vol. III, No.1, (2009), PP.49-65.

²¹ Burgers I.J. J, and Valderrama I. J, Fairness: A Dire International Tax Standard With No Meaning: *Intertax*, Vol. 45, No.2, (2017), P. 769.

²² Thomas M. Franck, Fairness in International Law and Institutions, *Clarendon Press*, (1998), P. 46; Michael Akehurst, Equity and general principles of law, *International & Comparative Law Quarterly*, Vol. 25, No.4, (1976), P. 828.

tax is fair it means a tax that treats equitably individuals who are situated alike.²³

ii. Equality

A more stable foundation of the principle of ability-to-pay can also be built considering such principle as a corollary of the equality principle.²⁴ This is because the ability-to-pay principle is based on equality and places a limit on the state's power of taxation to ensure fair distribution of the burden among taxpayers. Equality requires similar (comparable) situations to be treated the same way and different situations to be treated differently. Accordingly, the ability-to-pay can be seen as a manifestation of the equality principle. This can be justified by looking into Article 13 of the French Declaration on the Rights of Man and the Citizen (1789) which stipulates: "For the maintenance of the public force and for the expenditures of administration, a common contribution is indispensable; it must be equally distributed to all the citizens, according to their ability-to-pay."²⁵

iii. Standard of Living

Another justification for the right to contribute, according to the ability-to-pay, is comprised of certain rights classified as "economic rights"; the right to own property, the right to work, and in general, the right to have a standard of living. According to Article 25(1) of UDHR, 'everyone has the right to a standard of living adequate for the health and well-being of himself and his

²³ C. Eugnen Steuerle, And Equal (Tax) Justice for All?: *Tax Justice: The Ongoing Debate*, (2002) P. 256; J. Clifton Fleming, Robert J. Peroni, and Stephen E. Shay, Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income, *Florida Tax Rev.*, Vol.5, No.4, (2001), P. 301.

²⁴ Crespo, *supra* note 20, p.3.

²⁵ France National Assembly, Declaration of the Rights of Man and the Citizen Adopted by the National Assembly during its Sessions on August 20,21,25 and 26 and Approved by the King, Paris: Mondharre & Jean 1789 (here in after French Declaration)

family'.²⁶ The right to an adequate standard of living requires, at a minimum, that everyone shall enjoy the necessary subsistence rights: adequate food and nutrition, clothing, housing, and the necessary conditions of care.²⁷ Thus, taxing expenses made to satisfy the basic need would go against the ability-to-pay principle as it could affect the minimum subsistence of the taxpayer for which the taxpayer is believed to fulfil basic needs.²⁸

1.3. Understanding the Nexus between Taxation and Human Rights

The major responsibility of the government is to ensure that each member of society has the right to maintain his or her human dignity. Human dignity is the core of human rights as enshrined under the preamble and Article 1 of the UDHR. Emphasizing this fact, the preamble of UDHR states “[w]hereas recognition of the inherent dignity and of the equal and inalienable rights of all members of the human family is the foundation of freedom, justice, and peace in the world”, and Article 1 stresses that “[a]ll human ... are born free and equal in dignity and rights”. Similarly, Article 21/1/ and Article 24/1/ of the FDRE Constitution also clearly protect the right of everyone to respect his human dignity and honour.²⁹

Though taxation is a rarely explored topic on the human rights agenda, it is one of the most important policy instruments governments can deploy to generate the resources needed to realize the full range of human rights.³⁰ The issue of taxation has become a major subject of policy debate since the 2008

²⁶ The Universal Declaration of Human Rights (UDHR), United Nations General Assembly, New York, 1948.

²⁷ *Id.*

²⁸ William Glenn Gale, What can America learn from the British tax system?, *National Tax Journal*, Vol. 50, No.4, (1997), P. 758.

²⁹ The Constitution of Federal Democratic Republic of Ethiopia, Proclamation No.1/1995, Federal Negarit Gazette, (1995), [hereinafter FDRE Const.].

³⁰ Era Dabla-Norris, Kalpana Kochhar, Nujin Suphaphiphat, Frantisek Ricka, Evridiki Tsount. *Causes and consequences of income inequality: A global perspective*. International Monetary Fund. (2015). P. 38

global financial crisis, which brings new manifestation of poverty, inequality, and economic dynamics.³¹

The effort to analyse the implications of tax for the respect of human rights and scrutinize the content of tax rules through the lens of human rights law became also a concern.³² A notable move by the United Nations is the 2014 report on fiscal policy by the UN Special Rapporteur and the appointment of an independent expert on 23 March 2017 by the UN Human Rights Council Resolution No. 34/3. The 2014 report on fiscal policy by the UN Special Rapporteur on extreme poverty and human rights endorses taxation as a key tool for tackling inequality and generating the resources necessary for poverty reduction and the realization of human rights.³³ Similarly, the independent expert was mandated to investigate the impact of illicit financial flows on the enjoyment of human rights from which the independent expert Juan Pablo Bohoslavsky issued a report on how tax policies affect the enjoyment of human rights.³⁴

In addition, the nexus between taxation and human right has come into focus through human rights publications such as the International Bar Association's 2013 report on tax abuses, poverty, and human rights,³⁵ A similar publication

³¹ Id.

³² Manoj Kumar Bharti Creating a Shared Future in Fractured: *International relations, part "Economic sciences"*, 1 (15), (2018), P. 6

³³ Magdalena Sepúlveda, Report on taxation and human rights (A/HRC/26/28), submitted by the Special Rapporteur on extreme poverty and human rights, (2014) P. 8

³⁴ UN Human Rights Council, Mandate of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights Resolution No. 34/3, (2017); see also Mr. Juan Pablo Bohoslavsky, End of mission statement of the United Nations Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, to his visit to Switzerland, 4, Oct. 2017, <https://www.ohchr.org/en/statements/2017/10/end-mission-statement-united-nations-independent-expert-effects-foreign-debt-and> (Last Accessed 2/3/2022)

³⁵ Thomas Pogge, Tax Abuses, Poverty and Human Rights; A report of the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows,

has been issued by Christians Fair Taxation as a basic human right³⁶ and Worster's Publication on Human Rights Law and the Taxation Consequences for Renouncing Citizenship.³⁷ These publications challenge the inadequacy and inequity of tax policies for the enjoyment of human rights domestically and internationally and strive to treat tax policy as human rights policy.

Accordingly, taxation from a human rights perspective has three roles : its role in generating the 'maximum available resources to finance human rights-related expenditure; its potential role in redistributing resources in order to mitigate and redress social inequalities; and its role in cementing the bonds of accountability between state and citizen.³⁸ Thus, it can be argued that tax makes resources available whereas tax policy demonstrates tangible action in setting priorities. If carefully implemented, tax is the government's most important policy tool to the realization and protection of human rights.³⁹ In such cases, the exemption of the minimum for subsistence and redistributive policies could increase equality and growth.⁴⁰ Many writers also recognize that a person's vulnerability to tax injustice might be associated with various aspects of his or her situation in life and that the intrusiveness of the government in determining one's susceptibility to taxation should influence the choice of a tax base.⁴¹

Poverty and Human Rights. *International Bar Association*, (2013) P. 8; see also William Thomas. Human Rights Law and the Taxation Consequences for Renouncing Citizenship. . *Louis ULJ*, 62, 85. (2017). P. 62

³⁶ Allison Christians, Fair Taxation as a basic human right: *International Review of Constitutionalism*, (2009), P. 215.

³⁷ Worster, W. T. Human Rights Law and the Taxation Consequences for Renouncing Citizenship. . *Louis ULJ*, 62, 85. (2017), Pp. 87-88.

³⁸ Nolan, A., O'Connell, R., & Harvey, C., *Human rights and public finance: Budgets and the promotion of economic and social rights*. Bloomsbury Publishing, (2013), P.78

³⁹ Id.

⁴⁰ Id., P. 61; See also Goraus-Tanska K.. and Inchauste G, *The distributional impact of taxes and transfers in Poland*, (World Bank Policy Research Working Paper, WPS7787, 2016), p. 11.

⁴¹ Edwin Robert Anderson Seligman, *Progressive Taxation in Theory and Practice*, *American Economic Association Quarterly*, Vol.11, No.2, (1894), p.151.

1.4. The Role of Tax in Reducing Poverty

Scholars such as Chernick and Reschovsky noted that raising the personal exemption, the standard deduction, and the earned income tax credit, reduced the number of poor families and helped millions below the poverty level.⁴² Immervoll et.al., based on a detailed analysis of the targeting efficiency of tax and other cash benefits, also revealed that a number of these benefits are quite successful in targeting the most vulnerable population.⁴³

In assessing the effectiveness of earned income tax credit, Hoynes & Patel, in another study, revealed how the sizable contribution of earned income tax credit (EITC) in reducing poverty is significantly understated.⁴⁴ In their research, it was found out that that the EITC removes 1.8 million children from poverty.⁴⁵

The same position is held by Higgins & Lustig on the role of transfers, subsidies, and taxes for poverty reduction. They stated that these measures can lead the tax and transfer to a system unambiguously benefiting the poor.⁴⁶ Indeed, they observed that out of seventeen developing countries from which they have collected data, fifteen have tax and transfer systems that unambiguously reduce poverty. The same holds true in studies conducted by Atkinson *et. al.* The latter group of scholars have revealed that each of the tax and transfer reform packages has a substantial impact on summary measures

⁴² Howard Chernick and Andrew Reschovsky, The taxation of the poor, *Journal of Human Resources*, Vol.25, No.4, (1990), P. 716.

⁴³ Immervoll Herwig, Levy Horacio, Nogueira José Ricardo, O'Donoghue Cathal, de Siqueira Rozane Bezerra, *The impact of Brazil's tax-benefit system on inequality and poverty*, (IZA Discussion Papers, No. 2114, 2006), P.11 Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=900832 (Last Accessed on March 4, 2022).

⁴⁴ Hilary W. Hoynes, and Ankur J. Patel, Effective Policy for Reducing Poverty and Inequality? The Earned Income Tax Credit and the Distribution of Income, *Journal of Human Resources*, Vol. 53, No.4, (2018), P. 865.

⁴⁵ *Id.*

⁴⁶ *Id.*

of inequality and poverty.⁴⁷ They further noted that, when more sensitive summary measures are used, the impacts of the tax/transfer reforms are considerably larger thereby justifying the claim that enhanced direct redistribution can be a major element in a broader strategy aimed at tackling inequality.⁴⁸

Turning to another policy practice, the principal policy changes, geared towards reducing poverty since 1997 in the UK, have been the introduction of or increases in the National Minimum Wage, Working Families Tax Credit, and Income Support change targeted at children (replaced and enhanced by Child Tax Credit and Working Tax Credit), Minimum Income Guarantee for Pensioners (replaced and enhanced by the Pension Credit) and Winter Fuel Payments.⁴⁹ Changes to income tax and national insurance contributions as well as some benefits not listed above have also affected poverty. This is an evidence to the fact that designing tax policy on the principle of the ability-to-pay does actually reduce poverty.

Research conducted in Ethiopia on the likely implication of government transfer schemes to households reveals that the transfer scheme can be used as a policy to reducing poverty.⁵⁰ Supporting this assertion the author could find out evidences showing that the proportion of poor has shown decreases by 3.4% (national), 3.5% (rural), and 2.3% (urban).⁵¹

Thus, in its direct way, tax has a role to play in the distribution of society's resources and indirectly through its effects on the incentives for the economy.

⁴⁷ Atkinson et al, *supra* Note 7, pp. 305-306.

⁴⁸ *Id.*

⁴⁹ Holly Sutherland, Tom Sefton and David Piachaud, Poverty in Britain: The impact of government policy since 1997, (2003), pp.8-12 Available at <http://www.jrf.org.uk/knowledge/findings/socialpolicy/043.asp> (Last accessed on March 2, 2021)

⁵⁰ Daniel Abraham Mengistu, The Impact of Fiscal Policy on Poverty in Ethiopia: A Computable General Equilibrium Microsimulation Analysis, *Ethiopian Journal of Economics*, Vol. 22, No. 1, (2013), pp.25-70, P. 56.

⁵¹ *Id.*

As such, it tries to reduce poverty and the impact of the rise of cost on those who are poor and below the poverty line. One very obvious way in which the tax system is relevant to the reduction of poverty is the impact taxes have on the incomes of households below or close to the poverty line.⁵² One example of a tax system that supports a policy for the reduction of poverty would be one that reduces the tax liabilities of households in poverty.⁵³ This can be effective in various ways including guaranteeing that the tax laws are enacted in such a way they protect the ability-to-pay principle of tax laws.

2. Experiences of Other Countries

In the review of the experience of other countries, the income tax system of France and United Kingdom from Europe and Ghana & Kenya from Africa were selected for legal comparison. France and UK are chosen because of their well-developed legal systems in the world from which we can also share good experiences. Most importantly, both countries have good experience on tax credits and deductions that have contributed, despite other factors, to driving their citizens out of poverty and reducing income inequality and which can be best experience for Ethiopia.⁵⁴ Ghana and Kenya are also selected on the ground that Ethiopia, Ghana, and Kenya are in the same trend of economic development and Ghana & Kenya have a good experience in the administration of tax exemptions and deductions that helped them reduce

⁵² Atkinson et al, *supra* Note 7, P. 308.

⁵³ Ivaškaitė-Tamošiūnė Viginta, Maestri Virginia, Malzubris Janis, Poissonnier Aurélien and Vandeplas Anneleen, *The Effect of Taxes and Benefits Reforms on Poverty and Inequality in Latvia* (No. 039), Directorate General Economic and Financial Affairs (DG ECFIN), European Commission, (2018), P. 11.

⁵⁴ Rafael A. Espinoza and Esther Perez Ruiz, *How Do Fiscal and Labor Policies in France Affect Inequality?*. International Monetary Fund, (2016), P. 56; see also BuRkhause R. V. The minimum wage versus the earned income tax credit for reducing poverty, *IZA World of Labor*, (2021), P. 9; See also Rod Hick & Alba Lanau, Tax credits and in-work poverty in the UK: An analysis of income packages and anti-poverty performance, *Social Policy and Society*, 18(2), 219-236, (2019), pp.219-236, P. 225.

poverty situation.⁵⁵ In that sense, experience of these countries may be feasible in Ethiopia.

2.1. The French tax system

France introduced a progressive income tax system in 1911 and family splitting, as opposed to individual system.⁵⁶ Since 1948, there has been a move to adapt the fiscal contribution of the household to its financial ability, taking into account the total number of household members, including children.⁵⁷ From a pro-nationalist perspective, it was clear from the outset that tax exemptions may promote marriage and population growth.⁵⁸ However, it will be unlikely to imagine having children to be benefit from a tax exemption would be tempting to families in France. Thus, the French experience in relation to splitting system shall be cautiously construed taking into account the population policy of Ethiopia. Concerning calculating tax exemption

⁵⁵ Clirre Kumar, Africa rising: Inequalities and the essential role of fair taxation, African Forum and Network on Debt and Development (AFRODAD 2014), P.23. see also The Africa initiative, Tax Transparency in Africa 2021 report highlights key role of EOL, (2021), pp, 41-45; see also Nancy Nafula, Denis Kyalo, Boaz Munga, & Roze Wanjiru Ngugi, Poverty and distributional effects of COVID-19 on households in Kenya, (2020), P. 16-20; see also Jacob Novignon, Justice Nonvignon and Richard Mussa, The poverty and inequality nexus in Ghana: a decomposition analysis of household expenditure components, *International Journal of Social Economics*, (2018), P 23.

⁵⁶ In an individualised system, the incomes of both spouses are kept separate for tax purposes. In a splitting system, the joint income is divided over both partners before tax is calculated. Income splitting is a tax policy of fictionally attributing earned and passive income of one spouse to the other spouse for the purposes of assessing personal income tax. Countries with a splitting system automatically have, in effect, a progressive income tax system. In a splitting system, it makes no difference for the tax burden who contributes the income. There are various types of splitting systems. Some like UK, Sweden and Austria are directed at spouses, while others such as France focus on families.

⁵⁷ Laisney François, Beninger Denis, and Beblo Miriam, Family Tax Splitting: A Micro-simulation of its Potential Labour Supply and Intra-household Welfare Effects in Germany, (ZEW Discussion Papers 03-32, 2003), P. 7

⁵⁸ Cicely Watson, Population policy in France: Family allowances and other benefits II, *Population Studies*, Vol. 8, No.1, (1954), pp.46-73, P. 49.

based on the splitting divisor is very much important in considering tax exemption based on the number of dependants in Ethiopia.

Accordingly, the splitting divisor is increased by 0.5 for the first and second child, and by 1 for the third and every subsequent child.⁵⁹ In so doing, for a married couple with two children, the factor is 3 and with a family income of € 90,000, the tax burden imposed is calculated over an income of € 30,000 and then multiplied by a factor of 3.⁶⁰ Based on the tax rate of French income tax, this gives a tax liability of € 8,763.⁶¹ Scholars such as Beblo *et. al*, argues that the French family splitting provides certain equity among families with comparable endowments.⁶² In addition to these tax benefits for married couples, there is a tax-deductible allowance of 10 percent of salary for work-related expenditure. Also, there is a deduction for maintenance payments⁶³ and a bonus for working people.⁶⁴ Finally, the tax burden changes in line with different forms of cohabitation.

2.2. The UK tax system

Income tax in the United Kingdom (UK) is tailored to the taxpayer's ability-to-pay by way of introducing tax credits. Accordingly, Child Tax Credit which was applied in UK is calculated at £ 545 for the family element, £ 2,935 per child element (paid for each child or qualifying young person), £ 3,545 is paid for the disability element, where the child or qualifying young

⁵⁹ In France, not only married couples but also spouses or two other people who signed the PACS ('Pacte civil de solidarité') are eligible to income splitting (although not immediately as married couples).

⁶⁰ Van Kruiningen, Fair Tax and Families, A comparative study with a view to a more equitable income tax, P. 22, available at <https://sallux.eu/Family%20and%20fair%20taxation%20def.pdf> (Last Accessed on March 2, 2022).

⁶¹ The tax rate in France is up to the first 10,225 Euros are taxed at 0%. From 10,225 € to 26,070 €, is taxed at of 11%. From 26 070 € to 74545 €, the tax rate is 30% and increased progressively to 41% for those incomes greater than 74545 €.

⁶² Beblo *et. Al*, *supra* Note 57 p. 82.

⁶³ Van Kruiningen, *supra* note 60, P. 22.

⁶⁴ *Id.*

person is disabled (paid in addition to the child element) and £4,975 for the disability element of Child Tax Credit, where the child or qualifying young person is severely disabled (paid in addition to the child element).⁶⁵ In that, Child Tax Credit will be paid directly to the main caregiver for all the children in the family.⁶⁶ If they are couples he/she needs to tell tax authorities which one of them (the husband or the wife) is the main caregiver to the child.⁶⁷

Despite this, since 6 April 2017, the individual child element of the Child Tax Credit is no longer awarded for third and subsequent children or qualifying young persons in a household, born on or after 6 April 2017, and is being replaced by Universal Tax Credit. Also, unless a person is currently getting Working Tax Credit, he can no longer make a new claim for Child Tax Credit and must apply for the child element of Universal Credit instead up to a maximum of £646.35 for one child or £1,108.04 for two or more children.⁶⁸ A deduction is also available for blind people.

2.3. The Ghana's Tax System

Ghana realized significant poverty reduction in line with the first Millennium Development Goal.⁶⁹ Ghana's poverty rate was 47.4 percent in 1991 and decreased to 13.3 percent in 2016.⁷⁰ Its extreme poverty rate fell from 76 percent to only 45.2 percent between 2005 and 2016.⁷¹

⁶⁵ A guide to Child Tax Credit and Working Tax Credit, Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1064064/WTC2-2022.pdf (Last Accessed on March 2, 2022)

⁶⁶ Id.

⁶⁷ Id.

⁶⁸ Id.

⁶⁹ Vasco Molini and Pierella Paci, *Poverty Reduction in Ghana : Progress and Challenges*, (2015), P3.

⁷⁰ Id.

⁷¹ Ali-Nakyea Abdallah, *Taxation in Ghana: Principles, Practice and Planning*, 3rd edition, Accra: Black Mask Ltd, (2008), P. 107; see also Mavis Pobb, Samuel Gameli Gadzo, Emmanuel Atta Anaman, Philip Yamoah Esse, & Holy Kwabla Kportorgbi,

It should be noted that the reduction of poverty in Ghana is not a surprise but rather a manifestation of different poverty reduction strategies adopted by the government since 1991. One of these strategies is the adoption of personal tax reliefs.⁷² The personal reliefs allowed in Ghana are a tax-free threshold of GH¢ 4380, children's education school fee relief of GH¢600 per Child, Marriage/Responsibility Relief of GH¢200, Disability Relief of 25% of that individual's assessable income from business and/or employment, Old Age Relief of GH¢1500, Aged Dependent Relief of GH¢1,000, and Professional, Technical or Vocational Training Relief of GH¢2000 per year.⁷³ Also, personal income tax, expenses, and limitations are reviewed and updated by the Ghanaian government periodically.⁷⁴ This is made to support the economic growth in Ghana or to provide specific tax reliefs in the country. As part of this effort, the tax-free income threshold (worth GH¢ 4,380 per annum) aligned with the current daily minimum wage in Ghana is 12.53 Cedis (375.90 per month).⁷⁵

2.4. The Kenya's Tax system

The Kenyan tax systems are expected to honour the principles of ability-to-pay taxes and equitable taxation by various means including the provision of some tax exemptions for incomes needed to obtain the basic necessities of living.

The personal income tax in the country is governed by the Income Tax Act where the tax rates on income increase progressively from ten percent to 30

Utilization of Personal Tax Relief Schemes: An empirical Analysis in the Context of Tax Evasion, *Journal of Accounting and Taxation*, Vol.10, No.8 (2018), P. 102.

⁷² Id.

⁷³ According to a new Act 1071 adopted in 2022 that amends the Income Tax Act 2015 (Act 896) and Act 1007, the tax-free income threshold is increased from GH¢1584 to GH¢ 4,380.

⁷⁴ Ghana Business news, National Daily Minimum Wage for 2021, Available at <https://www.ghanabusinessnews.com/2021/06/05/national-daily-minimum-wage-for-2021-is-gh¢C2%A212-53/> (Last Accessed on March 3, 2022)

⁷⁵ id.

percent.⁷⁶ The Income Tax Act provides personal relief to taxpayers.⁷⁷ Currently in Kenya, every income up to KSh. 24000 is taxable at 10% and every resident individual is entitled to ‘personal relief,’ of KSh. 2400.⁷⁸ In addition to personal relief, interest paid on an amount borrowed from financial institutions up to a maximum of KSh. 300,000 per annum,⁷⁹ pension contribution by an employee to a maximum of KSh. 240,000 per annum, insurance premiums paid up to a maximum of KSh 60,000 are deductible.⁸⁰ In addition, Articles 13.2 and 35.1 of the *People with Disabilities Act* (PWD Act) 2003 of Kenya provides that an employee with a disability is entitled to a tax exemption on all income derived from his employment who earns below Ksh 150,000 per month or for their first KES 1,800,000 per year.⁸¹ Besides, Kenya has made regular reviews of the income threshold and personal relief as the main instruments of re-distributive taxation.⁸² Thus, the equity question and support for the poor have mainly been addressed through various adjustments to the income threshold and the personal relief. Because of this, income tax brackets aimed at cushioning poverty have resulted in about 1.3 million taxpayers being dropped from the tax net since 1981.⁸³

⁷⁶ Moses Kinyanjui Muriithi and Eliud Dismas Moyi, *Tax Reforms and Revenue Mobilization in Kenya*, (African Economic Research Consortium, Working Paper 131, 2003), P.11.

⁷⁷ The Income Tax Act, on 1st January, 1974, (Cap 470) Revised Edition, 2021.

⁷⁸ Pay As You Earn (paye) Guide, Kenyan Revenue Authority, Available at <https://www.kra.go.ke/images/publications/Pay-As-You-Earn-Guide-2022-.pdf> (Last Accessed on February 3, 2022).

⁷⁹ Annah Grace Kemunto, Evaluating Kenya’s Tax Law Changes on PAYE, (March 19, 2021), (2021), Available at <https://ieakenya.or.ke/blog/evaluating-kenyas-tax-law-changes-on-pay-e-in-january-2021/> (Last Accessed on March 2, 2022).

⁸⁰ Id.

⁸¹ Id.

⁸² Eliud Moyi and Eric Ronge, Taxation and tax modernisation in Kenya: A diagnosis of performance and options for further reform, (Nairobi Kenya : Institute of Economic Affairs, 2006), pP. 3-8.

<https://www.africportal.org/documents/12008/Tax-Revenue-Performance-in-Kenya1.pdf> (Last Accessed on March 4, 2022).

⁸³ Stephen Njuguna Karingi, and Bernadette Wanjala, *The tax reform experience of Kenya*, UNU-WIDER, Working Paper 67/2005, 2005) (No. 2005/67), P. 7.

3. Ability-to-pay principle and Its Poverty Reduction Role in the Ethiopian income Tax System

3.1. The Policy and Legal Framework

The principle of setting tax duties based on the taxpayer's ability-to-pay is accepted in most countries as one of the bases of a socially just tax system in their tax policies or constitution.⁸⁴ This move is premised on the ground that tax policy plays a fundamental role in redressing inequalities in society and in shaping accountability mechanisms.⁸⁵

However, looking into the Ethiopian legal framework, we may not find a separate tax policy document issued and publicized by the government. The only document, if at all, with this mission is the national strategic Growth and Transformation Plans (GTPs). In the past few years, the government of Ethiopia has formulated these plans to be executed in three phases: GTP I (2010/11-2014/2015), GTP II (2015/2016- 2019/2020), and now the 10-year development plan under the theme of 'Ethiopia: An African Beacon of Prosperity' for the years 2020/21 to 2030/31. These strategic policy documents have nothing to say about the ability-to-pay principle of taxation. The primary aim or focus of the strategic plans is that of improving the enforcement powers of tax laws and administration to raise revenue adequate to finance development.⁸⁶ The plans aim to broaden the tax base and this has

⁸⁴ Tadesse Lencho, The Ethiopian income tax structure: Policy, Design and practice, Value', *European Law Journal*, Vol. 19, No. 4, (2014), P.102.

⁸⁵ Nasser Abdel Karim, Annad, *Tax justice and sustainable development in the Arab Region: Lessons from four countries*, (Arab Network for NGO Development, April 8, 2019), Available at

<https://www.annd.org/en/publications/details/tax-justice-and-sustainable-development-in-the-arab-region>(Last Accessed on November 4, 2022); see also Jorge Martinez-Vazque, Violeta Vulovic, and Blanca Moreno Dodson, The impact of Tax and Expenditure Policies on Income Distribution: Evidence from a Large Panel of Countries. *Review of Public Economics*, Vol. 200, No.1, (2012), p.98.

⁸⁶ MOFED, Growth and Transformation Plan (GTP) 2010/11-2014/15, the Federal Democratic Republic of Ethiopia, Addis Ababa, (2010), P, 32.

an indirect effect on the equitability of the Ethiopian tax system.⁸⁷ Sadly, the government has not issued an official tax policy document either in general or on the ability-to-pay principle of tax in particular.

Moreover, the FDRE Constitution is silent about the principle of ability-to-pay. The Constitution has included a list of rights and freedoms. But there is no clear provision that grants the taxpayer to pay according to his/her ability. Yet, it can be argued that the Constitution is not fully unmindful of the ability-to-pay principle for it recognizes the right to equality as one of the fundamental rights and freedoms of citizens.⁸⁸ The principle of equity in taxation expresses the idea that taxes should be fair as one of the principles that guide tax policy.⁸⁹ Tax equity is a major policy objective of the government of Ethiopia.⁹⁰ It was even one of the major motivations for the comprehensive tax reforms of 2002 and 2016.⁹¹ The FDRE constitution specifies that the government has to ensure that all Ethiopians get equal opportunity to improve their economic condition and to promote equitable distribution of wealth among them.⁹² The contrario-reading of this provision suggests that the FDRE constitution impliedly recognizes the principle of ability-to-pay tax. This is even justified from the reading of Article 100 where the constitution requires that taxation shall be determined based on proper consideration.⁹³ So, we can conclude that the FDRE Constitution has recognized this right implicitly.

Concerning income tax laws, the Ethiopian income tax system is comprised of two separate income tax regimes (the federal and the regional). Although

⁸⁷ Id.

⁸⁸ The FDRE Constitution Preamble, Article 3/1/, 5/1/, 25, 34, 35, 41/3/ and 42/1/d/.

⁸⁹ Michael Akehurst, *supra* note 22, P. 830.

⁹⁰ Tadesse Lencho, *supra* note, 85, P.107-109.

⁹¹ Id.; See also Harris and Seid *supra* note 5, P. 12.

⁹² See Arti 89 of FDRE Constitution.

⁹³ Article 100 of the FDRE Constitution states that;- In exercising their taxing powers, States and the Federal Government shall ensure that any tax is related to the source of revenue taxed and that it is determined following proper considerations.

States have the power to levy and collect taxes on employees of the state and private enterprises according to Article 97/1/ of the FDRE Constitution, the income tax proclamations of regional states is a verbatim copy of the Federal income tax proclamation. Thus, as the scope of this research is to consider the design structure and system of income from employment in line with ability-to-pay principle, it's so important to test whether the employment income taxation system in Ethiopia is designed according to the ability of the taxpayer. In that regard, the Ethiopian income tax system is "schedular" in structure and separate taxes are imposed on different categories of income like income from employment, income from rental of property, and income from a business.⁹⁴ As Seligman noted, when indirect taxes exist, they often hit the poor harder than the rich.⁹⁵ So, progressivity of income taxes helps to act as an engine of reparation for such poor and respects the payment of taxes based on faculty (ability). In so doing, he recommends that in order to attain equal treatment, the regressive indirect taxes must be counterbalanced by the progressive direct taxes. Thus, the fact that the employment tax system in Ethiopia is schedular, is a step ahead in recognizing individuals' tax duty based on their ability.

The other way of recognizing the ability of the taxpayer in progressive tax systems is introducing the minimum of subsistence as exempted based on the idea of clear-income theory of taxation.⁹⁶ Exemption of minimum subsistence based on clear-income theory holds that the laborer's outlay for necessities are also expenses of production just like production expense is deducted for investment tax.⁹⁷ In that sense, the Ethiopian income tax proclamation has provided the minimum subsistence which is one of the keys to assessing

⁹⁴ Tadesse Lencho, *supra* note 84, P. 182.

⁹⁵ Edwin Robert Anderson Seligman, The theory of progressive taxation. *Political science quarterly*, 220-251, (1893), P.224-226; see also Henry Ordower, Schedularity in US income taxation and its effect on tax distribution, *Nw. UL Rev.*, Vol. 108, No. 905, (2013), P. 915; See also Wolfram F. Richter, From Ability to Pay to Concepts of Equal Sacrifice, *Journal of Public Economics*, Vol. 20, No.2, (1983), P. 92.

⁹⁶ *Id.*

⁹⁷ *Id.*

whether or not the taxation system is based on ability-to-pay. Yet, given the steadily soaring inflation and high cost of living, it is imperative to scrutinize whether or not the minimum subsistence set in the proclamation is sufficient.

In general, it can be argued that the federal income tax proclamation, while it fails to consider the different circumstances of the taxpayer and uses only individual as a taxing unit, appears, at least tacitly, to incorporate some of the ability-to-pay principle determinants and combines the requirements of both horizontal and vertical tax equity by imposing progressive income tax rates on the employment income.

The presence of ability-to-pay principle even with an implicit tone is significant for the taxpayers to defend themselves from excessive tax burden and it has also implications for other fundamental rights and freedoms. It also restrains the government from imposing an excessive tax and violates the socio-economic rights of a taxpayer. This is because the major responsibility of the government is to ensure that each member of society has the right to maintain his or her human dignity. Human dignity is the core of human rights as enshrined under the preamble and Article 1 of UDHR.⁹⁸

3.2. The Poverty Reduction Role of Applying the Ability-to-pay Principle

Many writers recognize that a person's vulnerability to tax injustice might be associated with various aspects of his or her situation in life and that the intrusiveness of the government in determining one's susceptibility to taxation should influence the choice of a tax base.⁹⁹ Seligman acknowledges that equal amounts of money revenue or the equivalent may not necessarily reflect an equal ability-to-pay, because of differences in "social demands," family needs, and so forth.¹⁰⁰ This is because, taxes, in so far as they took the means

⁹⁸ UDHR, *supra* Note 28

⁹⁹ Seligman, *supra* Note, 41, P. 151; Wolfram *supra* note 95; Slade Kendrick, The Ability-to-Pay Theory of Taxation, *The American Economic Review*, Vol. 29, No.1, (1939), P. 100

¹⁰⁰ *Id.*

of satisfying our wants, impose a sacrifice on us. Thus, the sacrifice from tax burden as Ricardo points out will be less if "the power of paying taxes is in proportion to the net, not to the gross, revenue."¹⁰¹ By net revenue, he means gross income, less expenses of production. That is, the laborer's outlay for necessities is also an expense of production and must be expected from tax to achieve. Thus, the demand for the exemption of the minimum of subsistence comes into the picture and is being applied in most legal systems of the world.¹⁰² This is because the minimum subsistence is a privileged part of all income to attain the ability-to-pay principle of taxation. In so doing, only the surplus above this minimum shall be assigned to the public for the support of government expenditure.¹⁰³

Accordingly, before we begin to tax any income of the poor, Seligman notes, we must, at least, ensure that his gross income is more than the amount required to cover subsistence expenses. Equally, it is unjust and unconstitutional to deduct tax from the income of the poor where that income is the absolute necessities of life for his family.¹⁰⁴ This scholar further points out, no man shall be bound to give to another what is essential to his subsistence by way of taxation.¹⁰⁵ One example of a tax system that supports a policy for the reduction of poverty would be one that reduces the tax duties of households in poverty.¹⁰⁶ This can be effective in various ways including guaranteeing that the tax laws are enacted in such a way that they protect the ability-to-pay principle of tax laws.¹⁰⁷ In other words, the taxation of an employment income shall be made, at least, taking into account the subjective ability of the taxpayer.¹⁰⁸ In that sense, though the determination of the tax

¹⁰¹ Seligman, *supra* Note 41, P. 155

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ Ivaškaitė-Tamošiūnė, et al, *supra* Note 53.

¹⁰⁷ *Id.*

¹⁰⁸ The subjective ability to pay is related to the individual's ability to contribute in relation to their personal circumstances, whereas the objective ability to pay refers to

unit is the economic power of the government, it should not tax all the taxpayer's wealth but should exclude the portion required to ensure at least a minimum standard of living. This includes the means required for housing, nutrition, medical insurance and services, and basic education.

Indeed, most income tax systems do not attempt to collect the Personal Income Tax from those with low incomes and realize tax fairness either by defining amounts of income that will be tax-exempt or by offering low-income tax credits to attain the ability-to-pay principle of taxation.¹⁰⁹ Many countries grant different forms of tax relief taking into account the number of children, marital status, or specific expenses linked to the personal needs of the taxpayer (such as medical expenses) using redistributing function tax.¹¹⁰ Some modern tax systems have grappled with these individual circumstances and attempted to take individual and family circumstances into account in distributing tax burdens.¹¹¹

In Ethiopia, however, it is the poor employees who are still sacrificing in taking the burden of tax and the highest price of increasing cost of living.¹¹² This is because the federal income tax proclamation has incorporated a list of exemptions for schedule "A" income taxpayers.¹¹³ The major exemptions are common exemptions for those whose salary is less than 600 Birr under Article 11 of the same and employer-paid health insurance benefits, transportation allowance, hardship allowance, per diem, traveling expenses,

the determination of income, or, more exactly, the kind of revenues to be considered as income for tax purposes.

¹⁰⁹ Philip Alston and Nikki Reisch, *Tax, Inequality, and Human rights*, (ed.), Oxford University Press, (2019), P.6

¹¹⁰ Chiara Bardini 'the ability to Pay in the European Market: An Impossible Sudoku for the ECJ', in *Intertax*, vol. 38, No.1,(2010), p. 4.

¹¹¹ Atkinson *supra* note 7, P. 310

¹¹² Interview with Mulay Weldu, Tax Policy Director, Ethiopian Ministry of Finance, and Abere Asefaw, Ethiopian Revenue Authority Legal service Director, (May 14, 2022).

¹¹³ Federal Income Tax Proclamation, (2016), *Federal Negarit Gazette*, Proclamation No 979, 22nd year, No.104, (here in after the income tax proclamation).

and food provided to the employee by the mining employer under Article 65 of the proclamation.¹¹⁴

It should be noted here that most of the exemptions provided are not pro-poor. This is because a significant portion of employees' salary is spent on food consumption for their families and themselves. Few employers are willing to cover the costs of meals for their employees fully or partially. However, the interpretation of the tax law by the tax authorities has discouraged employers from partially contributing or fully covering meal costs.

In this regard, a Circular issued by the Ministry of Finance dated Tikimit 5, 2007 E.C. states that except for employees in the manufacturing sector, the cost of provision of a meal by the employer could not be regarded as a deductible expense for the employer and should be added on the employee's salary as taxable income.¹¹⁵ This was partially revised in 2011 EC.¹¹⁶ Accordingly, more sectors were covered by the exemption, but a limit on the monthly costs was introduced.

The directive issued by the Ministry of Finance on deductible expenses states food provided by the employer to his employees will be considered as deductible expenses up to 30% of the monthly salary of each employee.¹¹⁷ This applies only to employers engaged in mining, manufacturing, agriculture, and horticulture. For employers in hotels, restaurants, and others providing food services, the deductible expense is 20% of the monthly salary of the employee.¹¹⁸

It is also possible to observe unfair treatment of deductible incomes of the employees under the Directive issued to regulate incomes free from income

¹¹⁴ Article 11 and 65 of the Income Tax proclamation.

¹¹⁵ Letter issued by Ministry of Finance dated tikimt 5, 2007.

¹¹⁶ ስለ ተቀናሽ ወጪዎች የወጣ መመሪያ ቁጥር 5; 2011 ኢትዮጵያ ፌዴራላዊ ሪፐብሊክ ፋይናንስ ሚኒስቴር (Hereinafter Directive No. 5/2019)

¹¹⁷ Id., Article 7(1)

¹¹⁸ Id, Article 7(2)

tax.¹¹⁹ A directive issued in this respect treats a significant portion of costs of transportation and allowance as non-deductible income.¹²⁰

At a national level, the size of employed population aged ten years and above, in February 2021, is 41,637,071 , while in June 2020 (the result of the Tigray Region excluded), is 39,856,378.¹²¹ Employed persons support not only themselves but also their dependents. From that perspective, the ability-to-pay principles will significantly alleviate the poor living conditions of working people if they are required to pay taxes according to their capacity and income. Underlying all these evidences is the fact that except for the exemption for those employees who earn less than 600 Birr, the rest of the exemptions tend to favor those in higher income brackets, not those who earn a lower income.

Another point worth mentioning is the issue of employees with children and yet earning low income. These segment of people with low salary experience the hardest strain of poverty,¹²² which seriously damages the future of children. According to Joseph Stigliz, Children from such families will likely inherit poverty from their parents and remain under the yolk of poverty in the next generation.

While it is clear that the risk of poverty is greatest in a family with a higher number of children and this is a major source of social and economic inequality, the Ethiopian income tax has given no attention to such vulnerable

¹¹⁹ ከገቢ ግብር ነጻ የተደረጉ ገቢዎች አፈጻጸም መመሪያ 1; 2011 የኢትዮጵያ ፌዴራላዊ ሪፐብሊክ ፋይናንስ ሚኒስቴር

¹²⁰ Id., Article 5/1/

¹²¹ Central Statistics Agency (CSA), Labour Force and Migration Survey Key Findings, (Addis Ababa, Ethiopia] 2021), Available at <https://www.statsethiopia.gov.et/wp-content/uploads/2021/08/Final-2021-LABOUR-FORCE-AND-MIGRATION-SURVEY-Key-finding-Report-17AUG2021.pdf> (Last Accessed on May 15, 2022).

¹²² Interview with Selam Endale, public Servant, Federal First Instant Court, (May 15, 2022), Interview with Tinebeb, public Servant, Ministry of Revenue, (May 16, 2022), and Interview with Alemneh Bera, Employee in a PLC (May 17, 2022).

groups of society and income tax is not shaped to assist them.¹²³ In denying due attention to such segment of the society, the government is posing a dangerous threat to social and political stability that would mainly spring from inequality.

Looking retrospectively in the past years, the thresholds for personal income tax were dramatically eroded by inflation, resulting in an effect known as bracket creep.¹²⁴ The ultimate payers of the price are those whose earning is low.¹²⁵ Most strikingly, the exempt threshold in the Income Tax Proclamation, which is 600 Birr, is below the global poverty line in 2022.¹²⁶ The inflation rate was 6.63 at a point when the exempt threshold in the Income Tax Proclamation was adopted as 600 Birr (i.e. 2016). Yet, currently, Ethiopia is experiencing annual inflation rate of 35.1 percent in December which was the highest inflation rate since February 2012.¹²⁷

True that the exempt threshold of 600 Birr is adopted by proclamation No 979/2016 after a salary adjustment for public servants was made and after the

¹²³ Mulay Weldu, *supra* note 112.

¹²⁴ Bracket creep is a situation where inflation pushes income into higher tax brackets. The result is an increase in income taxes but no increase in real purchasing power. This is a problem during periods of high inflation, as income tax codes typically take longer to change than the rate of inflation.

¹²⁵ Evangelo Charalampkis, Bruno Fagandini, Lukas Henkel, and Chiara Osbat, *The impact of inflation on low income House Holds*, (ECB Economic Bulletin issue 7, 2022). Available at:

https://www.ecb.europa.eu/pub/economic-bulletin/focus/2022/html/ecb.ebbox202207_04~a89ec1a6fe.en.html (Last Acceed on March 2, 2022).

¹²⁶ R. Andres Castaneda Aguilar, Aleksander Eilertsen, Tony Fujs, Christoph Lanker, Daniel Gerszon Mahler, Minh Cong Nguyen, Marta Schoch, Samuel Kofi Tetteh Baah, Matha Viveros, Haoyu Wu , April 2022 Global Poverty Update, World Bank, (April 08, 2022), Available at <https://blogs.worldbank.org/opendata/april-2022-global-poverty-update-world-bank> (Last Accessed on 2/4/2022).

¹²⁷ Ethiopia inflation rate, Trading economies, Available at <https://tradingeconomics.com/ethiopia/inflation-cpi> (Last Accessed on April 2, 2022).

minimum wage was increased from 420 Birr to that of 615 Birr.¹²⁸ However, the government currently has introduced Job Evaluation and Grading (JEG) where the minimum wage level of public servants has increased from 615 Birr gradually to 1100 Birr despite the minimum threshold stipulated as an exemption being unchanged (i.e. 600 Birr).¹²⁹ A key informant from Civil Service Commission responded that there is no clear minimum wage set for public servants but agreed with the fact that the lowest amount of wage paid to guards and janitors in the JEG can be taken as a minimum wage.¹³⁰

Regarding the determination of wages for employees in private organizations, a respondent from the Confederation of Ethiopian Trade Unions revealed that the Confederation has already studied the minimum wage taking into account the country's economic development, labor market, and other considerations by a foreign researcher and is waiting for the formation of Wage Board in accordance with Article 55 of the labor proclamation.¹³¹ Yet the respondent got reserved from revealing the amount of minimum wage studied before the formation of the board since such power is given to the board.¹³²

With regard to the formation of the board, a respondent from the Ministry of Labor and skill has also stressed the importance of setting minimum wage and revealed that a draft regulation on the powers and duties of the board is already sent to the Prime Minister's office and the issue of Minimum wage will be settled after the adoption of the regulation by the Council of

¹²⁸ *Walta News*, ለመንግስት ሰራተኞች ከ33 እስከ 46 በመቶ የደመወዝ ጭማሪ ተደረገ, (August 2, 2014), Available at <https://waltainfo.com/am/25047/> (Last Accessed on April 2, 2022).

¹²⁹ የኢትዮጵያ ፌዴራላዊ ዲሞክራሲያዊ ሪፐብሊክ ሲቪል ሰርቪስ ኮምሽን፤ የነጥብ የሥራ ምዘናና ደረጃ አወሳሰን ጥናት የደሞዝ እስኬል አፈጻጸም መመሪያ ቁጥር 1/2012 አባሪ አንድ

¹³⁰ Interview with Selam Ayalew, Deputy Manager, Federal Civil Service Commission, (May 13, 2022).

¹³¹ Labour Proclamation, Proclamation No.1156/2019., Federal Negarit Gazette No. 89, 5th September, 2019.

¹³² Interview Kassaahun Follo, president of Confederation of Ethiopian Trade Unions, (May 16, 2022).

Ministers.¹³³ The respondent also believes that the minimum wage coupled with the tax measures, based on the ability-to-pay, could help the employees cope with the effects of poverty and inflation.¹³⁴

Here, a state has an obligation to provide its citizen with a minimum standard of living as a core obligation. As pointed out above, Article 25 of UDHR provides that everyone has the right to an adequate standard of living. However, although some consider it as a gradual obligation, a state has to refrain from any act that violates this right to a minimum standard of living including imposing excessive tax that could lead to the violation of such human rights obligations. Excessive tax burden has apparently an adverse effect on individual taxpayers and the welfare of a family thereby endangering the right to an adequate standard of living as enshrined under the UDHR to which Ethiopia is also a member. For that reason, the minimum threshold shall be designed to protect the family from a low standard of living and help the family to fulfil all necessary things for their existence, i.e. food, shelter, clothes, water, etc. In that, most countries grant exemptions or some tax relief taking into account the existence of children, marital status, or specific expenses linked to the personal needs of the taxpayer (such as medical expenses).¹³⁵

In Ethiopia, however, poor employees are still taxed heavily, paying the highest price resulting from the rise of inflation which increases from 6.63% at the time of the adoption of the income tax proclamation to 35% in 2022 endangering the full realization of the basic human right of the employees such as food, shelter, health, etc.¹³⁶ Accordingly, if a person has no means or is unable to provide his/her basic needs because of the effect of high cost of

¹³³ Interview with Hana Maru, Lawyer, Minister of Labor and skill, (May 9, 2022).

¹³⁴ Id.

¹³⁵ Dabla-Norris, M. E., Kochhar, M. K., Suphaphiphat, M. N., Ricka, M. F., & Tsounta, M. E. *Causes and consequences of income inequality: A global perspective*, International Monetary Fund, (2015), p.4.

¹³⁶ Ethiopian Inflation Rate, *supra* Note 127.

living and the lower income he has obtained as a result of improper taxation without considering his ability, he will be unable to feed himself or of his family thereby endangering the full realization of basic human rights.

Moreover, the respondents in the key informant interviews criticized the Income Tax Proclamation schedule for not incorporating an exception to deductible expenditures for employees.¹³⁷ Employees who have high number of dependents with low wages are really in absolute poverty and their right to a dignified standard of living in the FDRE Constitution and human rights instruments is endangered. Accordingly, they noted that the number of dependents should be considered while determining the tax on individual employee taxpayers.¹³⁸ Additionally, interviews with disabled persons and associations with disabilities revealed that disabled persons incur extra expenses than normal persons merely because they are disabled.¹³⁹ For example, if a blind wants to drink coffee, he has to pay also for his assistant.¹⁴⁰ The respondent from the Ethiopian Ministry of Finance replied that *“a study is underway on the income tax laws of the country and this new study might come with these special considerations”*.¹⁴¹

Thus, as noted in the review, the relationship between tax deductions, allowances, and benefits show the percentage reduction in poverty rates and the proportional reduction in poverty severity in different counties. There are clear positive relationships between tax policy and poverty reduction. And it

¹³⁷ Interview with Abedu Ruhuf Mohammed, Legal Expert on drafting and consulting, Ministry of Revenue, (May 2, 2022), Interview with Tayo Maserasha, Income tax administration Directorate Director, Addis Ababa Revenue Authority, (May 3, 2022), Interview with Belachew Asefa, Oromiya Regional State Adama City Revenue Bureau Director, (May 4, 2022) and Interview with Tesema Abere, Head of Amhara Regional State Revenue investigation Directorate, (May 16, 2022).

¹³⁸ Id.

¹³⁹ Interview with Mohamed Abiye, A Blind Tax payer and General Attorney at ministry of Justice, (May 3, 2022), Interview with *Wesen Alemu*, President of the Ethiopian National Association of the Blind (ENAB), (May 6, 2022).

¹⁴⁰ Id.

¹⁴¹ Mulay Weldu, *supra* note 112.

is argued that tax measures and transfer systems have many goals and poverty reduction is just among them. Thus, tax measures especially revisiting the minimum subsistence and the taxing unit to include, at least, family as a base or providing different tax incentives and reliefs, at least, for those who have low income and disabled is something imperative for the effective realization of ability-to-pay principle and fair and equitable tax system in Ethiopia.

Most respondents in the key informant interview also do not doubt the idea that tax benefits which can include tax deductions, exemptions, or transfers for poor people, employees with a higher number of dependents, and disabled persons can help to tackle the high cost of living.¹⁴² This also can help achieve the poverty reduction policy of the country. Because tax benefits during inflation have a direct relationship with poverty reduction.¹⁴³ This shows that the tax measures have an impact on poverty reduction and alleviating the high cost of living. Yet, when it comes to effecting these measures, respondents believe that the constraints on tax administration are major roadblocks.¹⁴⁴

4. Concluding Remark and the way forward

As can be noted from the review of the literatures and other discussions above, the relationship between tax deductions, allowances, and benefits show the percentage reduction in poverty rates and the proportional reduction in severity of poverty in different countries. The literature consulted also shows that there are clear positive relationships between tax policy, poverty reduction, protection of human rights, and ability-to-pay. However, Ability-to-pay principle is almost an overlooked concept in the Ethiopian tax system in general and employment tax in particular. In so doing, the Ethiopian employment tax system demands reform to close down the legal gaps and practical problems created due to less attention given to the concept of ability-

¹⁴² Mohammed, *supra* Note 139.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

to-pay principle. Thus, the writers argue that, it is high time for tax measures especially revisiting the minimum subsistence threshold of 600 Birr provided in the Federal Income Tax Proclamation. In addition, taking into account the available resources, Ethiopian employment income tax system should adopt *family and disability* as a base, or provide tax incentives or reliefs (though the amount and manner is something to be ascertained through future research) for those who have low income and disabled. Finally, more studies need to be carried out on mechanisms for the effective realization of ability-to-pay principle in Ethiopia and the protection of human right accordingly.