Employment Income Tax in Ethiopia

Introduction

Individuals may receive various types of income such as wages or salary from employment, rent from letting houses or buildings, interest from lending/saving money, and profit from their trading activities or business. These individuals are required to pay income tax. They are ordered to do so by income tax proclamations, regulation and directives. The law specifies how and when these individuals have to pay the required tax. This article deals especially with the aspect of the law which applies to individuals who earn income from employment. According to the law, individuals who obtain income from their employment are required to pay tax. In line with internationally recognized best practice, employee's income tax liabilities are calculated and paid directly by their employer. As a result the government relies on employers to compute and withhold the tax to be paid by employees. To discharge this responsibility properly, employers may need to know in advance what counts as income or shall be able to distinguish what kind of income is to be taxed or not. This article provides guidance to help employers in this respect.

However, for comprehensive understanding, readers are strongly advised to refer to the proclamation No 286/2002, 608/2008, Regulation No. 78/2002, Directive No. 21/2009 and circular on severance tax.

2. What is Employment Income Tax?

Employment income tax is a tax on the earnings of an employee. The government collects this tax from any individual employees, other than contractors, engaged whether on a permanent or temporary basis to perform services under the direction and control of the employer. Employment income includes any payment or gain in cash or in kind received from employment by the employee subject to certain exemptions: see below.

Employment income is one of the most well known forms of tax in Ethiopia. In 2008/9 fiscal year, employment income tax amounting to 1.017 billion birr was collected from payments made by employers to employees. This represents 4.31% of the total revenue collected by the Tax Authority in that fiscal year.

3. What are the Tax bands, Tax Rates and deductible fees used to calculate Employment Income Tax?

The employee's income tax system divides taxable income into different tax bands. These are a range of income bands with different tax rates. Below is a schedule that specifies tax bands and their tax rates.

Employment income (per month)		Income tax payable (%)	Deductible fee
Over birr	To birr		
0	150	Exempt threshold	
151	650	10	15
651	1400	15	47.50
1401	2350	20	117.50
2351	3550	25	235.00
3551	5000	30	412.50
Over 5000		35	662.00

According to the above tax rate schedule, employees who earn up to 150 birr a month are below the threshold for paying employment income tax. It is presumed that this exemption has removed hundreds of thousands of low income employees from the tax roll. However, employees who earn 151 birr per month and above are liable to pay employment income tax. In order to impose a heavier tax burden on those employees who earn more, the government uses a progressive employment income tax system. Tax on income from employment has 6 bands or groups of rates. These are 10%, 15%, 20%, 25%, 30% and 35%. The minimum tax rate applied to income from employment is 10 percent while the maximum is 35 percent. These bands of rates in the above schedule are used to compute the tax due.

4. Who shall calculate and withhold the tax due?

Unless the payment is tax-exempt, the employer is responsible for calculating and withholding the tax from every payment to an employee and to forward it to the Tax Authority. By the Tax Authority, we mean the Ethiopian Revenues and Customs Authority (ERCA) Head Office or any of its branch offices established in any part of Ethiopia and the tax authorities of the Regional State. The tax to be paid to the Tax Authority by the employers can be transmitted through financial institutions delegated by the Authority or through electronically filing and payment system.

5. How employers can determine the tax to be withheld?

To determine the tax to be withheld, the employer may use a simple calculation method. In Ethiopia, employers can determine the tax to be withheld by following 3 key steps.

1. First add all the payments in cash and in kind made to their employees in a month.
2. Refer/consult a tax schedule (schedule that shows how much tax is owed for different amounts of income earned by the employee) to find the tax rate applicable on the income earned by the employee.
3. Multiply the taxable income by the tax rate and then minus the deductible fee: as indicated in the tax schedule.

   For example, an employer who pays to an employee 400 birr a month will then have 25 birr to be withheld i.e. 400x10/100-15= 25.

6. How tax on compensation and other funding is determined?

When companies cut jobs or reduce their workforce, they may offer-

1) Compensation
2) Severance
3) Annual leave

4) Bonus and other funding to laid-off workers. The employers shall take notice that these funding for laid-off workers is taxable. The base of calculation for the tax to be withheld is the amount of compensation divided by the final salary paid at the time of lay-off. This enables the employer to figure the specific period of time covered by the compensation. Then the employer calculates the tax to be paid on a monthly basis and multiplies it by the specific period of time covered by the compensation to figure the total tax to be levied on the total compensation.
Example 1, suppose the compensation offered to the employee is 30,000 birr and the final regular salary paid when compensation is granted is 2500 birr then the specific period of time covered by compensation is going to be 12 months i.e. 30000/ 2500= 12. Hence, the tax to be levied on or withheld from the monthly salary is 448 birr whereas the tax for the period covered by the compensation is 5376 birr i.e. 448 multiplied by 12.

Example 2, suppose the compensation offered to the employee is 30, 900 birr and the final regular salary paid when compensation is granted is 2500 birr then the specific period of time covered by compensation is going to be 12 month with a remainder of 900 birr. The employer is therefore required to withhold 93 birr on the remainder in addition to the tax amounting to 5376 birr.

Employers usually offer two month's severance pay to laid-off workers. The base of computation for the tax on severance shall be the final regular salary paid at the time of lay-off.

Bonus, annual leave and other funding to laid-off worker shall be summed up and be divided by the month stated in example 1 above. The result will be added to the monthly salary of the employee and then the tax due will be computed.

7, what are the exemptions allowed under income tax proclamations, regulations and directives?

7.1, exemptions under the proclamation:

According to the income tax law, not all incomes of the employee are taxable. The government may tax only a portion of some types of the employee's income. Therefore employers have to subtract incomes of employees that are not taxable.

Accordingly, article 13 of the proclamation No. 286/2002 declares the following categories of payments in cash or benefits in kind to be excluded from computation of employment income tax.

a) Income from employment received by casual employees who are not regularly employed provided that they do not work for more than one (1) month for the same employer in any twelve (12) months period.
b) Pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% (fifteen percent) of the monthly salary of the employee.
c) Subject to reciprocity, income from employment, received for services rendered in the exercise of their duties by:-
   i. Diplomatic and consular representatives, and
   ii. Other persons employed in any embassy, legation, consulate, or mission of a foreign state performing state affairs, who are national of that state and bearers of diplomatic passports or who are in accordance with international usage or custom normally and usually, exempted from the payment of income tax.
d) Income specifically exempted from income tax by
   i. any law in Ethiopia unless specifically amended or deleted by proclamation

ii. International treaty; or

iii. An agreement made or approved by the minister

e) Payment made to a person as compensation or gratitude in relation to:-

i. Personal injuries suffered by that person

ii. the death of another person

7.2 According to the income tax regulation No. 78/2002, the following incomes are exempted from tax.

a. Amounts paid by employers to cover the actual cost of medical treatment of employees.

b. Allowance in lieu of means of transportation granted to employees under contract of employment.

c. Hardship allowance for hot areas clearly defined by law.

d. Amounts paid to employees in reimbursement of traveling expenses incurred on duty;

e. Amounts of traveling expense paid to employees recruited from elsewhere than the place of employment on joining and completion of employment or incase of foreigners traveling expenses from or to their country, provided that such payments are made pursuant to specific provisions of the contract;

f. Allowances paid to members and secretaries of boards of public enterprises and public bodies as well as to members and secretaries of groups set up by the federal or regional government.

g. Income of persons employed for domestic duties.

7.3, Exemptions under directive No. 21/2009

The Authority has, based on directive No 21/2009, determined the amount of payments specified under item (b) (d) and (e) above. Accordingly, monthly travel allowances which are exempted from tax shall account for 1/4 of the employee's gross salary and it shall under no circumstances exceed 1000 birr. The daily travel allowance for an employee who travels outside of their regular work area to a place 25 k.m away may not exceed 150 birr or it shall under no circumstances exceed 4 percent of his or her salary.

Amounts paid to employees in reimbursement of traveling expenses incurred on duty shall under no circumstances exceed the standard air/ land fare.

- Travel allowance paid to a foreigner when he/she leaves the country at completion of his/her contract shall be made based on the work contract and taking into account air and land transport fare. The total weight of his/her baggage shall not exceed 300 k.g.

according to article 7 of the directive no. 21/2009, rewards for improving an existing technology or for creating a new one and/or introducing a new system which enables cost reduction may be exempted from income tax provided the reward giving organization is able to provide sufficient evidence that demonstrates the reasons behind giving the reward. The authenticity of the evidence must be beyond doubt.

If there is any doubt about the authenticity of the presented evidence, the authority may investigate the case to establish the truth and shall have the option to preclude the gift of the reward from being exempted of income tax.

7.4, What is the obligation of the manager/employer who paid allowances which exceed the amount exempted from tax?

In such cases, employers/mangers are required to add the amount paid to the employee's salary and deducting the tax, they must deposit it in the tax Authority's account on a monthly basis.

8, What are Non-deductible expenses?

According to sub article 4.2 of the directive No 21/2009, transport expenses from home to office and vise-versa, and expenses to beneficiary who use company cars are non-deductible expenses.

9, What is the specific time to pay the withheld tax?

The employer shall pay the withheld tax to the Tax Authority within 30 days of the ends of each calendar month. Each payment shall be accompanied by a statement with respect to each employee who derives taxable income for the month.

The statement shall be in the form and furnished in the manner prescribed by the Tax Authority and shall contain the following information.

a. The name, address and Tax Identification Number(TIN) of each employee;
b. The amount of taxable income derived by each employee from the employment;
c. The amount of tax withheld from that income and,
d. The amount of any tax exempt income derived by the employee.

If an employer finds out that his employee has more than one employment income and if he ascertains that the other employer has not aggregated the said income, he shall aggregate and withhold the tax thereof.

10, Can the employee pay the tax by herself or himself?

In some exceptional cases, the income tax proclamation requires the employees to pay their tax by themselves. For instance an employee working for more than one employer or an employee of an international organization having diplomatic immunity or working in embassies, missions and other consular establishments of a foreign government has the duty to declare and pay tax by herself or himself within 30 days of the end of each calendar.

11, What are the punishable criminal offences and Administrative Penalties?

A person who obtained more than one TIN, who evades the declaration or payment of tax, who makes false or misleading statement, who obstructs or attempts to obstruct an officer of the Tax Authority in the performance of duties, person involved in unauthorized tax collection will be considered to have committed tax offences and may be charged, prosecuted and appealed in accordance with the Ethiopian criminal procedure law.

Administrative penalties are also imposed on those tax-payers who fail to file a timely tax declaration, who underrates the amount of tax required to be shown, who fail to pay tax liability on the due date, failure to keep proper records, and to withhold tax, to meet TIN requirements.

Should you be interested to have further information, please call
Tax Assessment and Collection Directorate at:

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or call Customer Service Directorate at

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