The Impact of Tax Reform on Private Sector Development

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# Table of Contents

Acknowledgement ........................................................................................................................................ i
List of Tables ........................................................................................................................................ iv
List of Figures .......................................................................................................................................... iv
Acronyms and Abbreviations .................................................................................................................. v

1 Introduction ............................................................................................................................................. 1
   1.1 Background ........................................................................................................................................ 1
   1.2 Objectives of the Study .................................................................................................................... 2
   1.3 Methodology ...................................................................................................................................... 2
   1.4 Scope of the Study ........................................................................................................................... 3

2 Theoretical Basis and Literature Review ............................................................................................... 5
   2.1 Principles of Taxation and Tax Reforms ....................................................................................... 5
   2.2 Tax Reform Models ......................................................................................................................... 5
   2.3 Taxation Theory ............................................................................................................................. 6
   2.4 Country experiences ....................................................................................................................... 6
   2.5 Value-Added Tax (VAT) ................................................................................................................ 9
   2.6 Lessons from Tax Reforms ........................................................................................................... 13

3 Evolution of Ethiopian Tax Reforms and Review of the Current Tax Laws ...................................... 15
   3.1 Evolution of the Tax Reforms ....................................................................................................... 15
   3.2 Current Ethiopian Tax Laws ......................................................................................................... 16
   3.3 Examination of Tax Laws, Regulations and Implementation Directives ..................................... 21

4 Recent Macroeconomic and Government Revenue Performances .................................................... 25
   4.1 Recent Macroeconomic Performance ......................................................................................... 25
   4.2 Government Revenue and Expenditure ....................................................................................... 26
   4.3 Revenue Impacts of the Reform ................................................................................................. 30

5 Survey of the Impact of Tax Reform on the Private Sector ................................................................ 31
   5.1 General Principles of Taxation ................................................................................................. 32
   5.2 Tax Enforcement ......................................................................................................................... 37
   5.3 Compliance Costs ......................................................................................................................... 40
   5.4 Tax Administration ....................................................................................................................... 41
   5.5 Value-Added Tax .......................................................................................................................... 45
   5.6 Other Impacts of Tax Reform on Private Sector Development .................................................... 52
   5.7 Tax and Accounting Issues ....................................................................................................... 55
   5.8 Perspectives of Tax Officials and Practitioners ......................................................................... 57

6 Conclusions and Recommendations ..................................................................................................... 59
   6.1 Summary of Key Findings from Business Survey ...................................................................... 59
   6.2 The Impact of Tax Reform on the Private Sector ...................................................................... 60
   6.3 Impact of the Tax System on Government Revenues ................................................................... 67

References .................................................................................................................................................. 69

Tax Laws .................................................................................................................................................. 72
Tax Regulations .......................................................................................................................................... 72
Annex A. Selected VAT Regulations and Schedules ............................................................................... 73
Annex B. Macroeconomic Data ............................................................................................................... 75
Annex C. Simplified Schemes for VAT Accounting ............................................................................... 79
List of Tables

Table 1. Total Tax Compliance Burden of Selected African Countries ........................................8
Table 2. General Government Revenue and Growth Rates (2002/03-2007/08) ..........................26
Table 3. General Government Revenue ......................................................................................28
Table 4. Primary Survey Sample Characteristics .......................................................................31
Table 5. Secondary Survey Sample Characteristics .................................................................31
Table 6. General Government Revenue (2002/03-2007/08) ....................................................75
Table 7. General Government Revenue (1998/00-2007/09) .....................................................76

List of Figures

Figure 1. Tax revenue and Tax burdens on agriculture/non-agriculture sectors ....................29
Figure 2. Orientation of businesses in main survey .................................................................32
Figure 3. Perceived complexity of tax laws ..........................................................................33
Figure 4. The Degree of Transparency of the Tax Law ..........................................................33
Figure 5. Whether businesses receive prior information on changes ....................................34
Figure 6. Taxpayer education and information .....................................................................35
Figure 7. The Degree of Equity of the Tax System .................................................................36
Figure 8. The Degree of Neutrality of the Tax Law ...............................................................36
Figure 9. The Degree of Technical Capacity of the Tax Administration ...............................37
Figure 10. Enforcement mechanisms perceived as unfair .....................................................38
Figure 11. Reasons for non-registration for VAT by eligible businesses ................................38
Figure 12. Perceived Severity of Financial Penalties .............................................................39
Figure 13. The Costs of Complying with Tax Laws ...............................................................40
Figure 14. Impacts of high tax compliance costs on business ..............................................41
Figure 15. Major complaints concerning tax administration ...............................................42
Figure 16. Negative and Positive Impacts of Tax reform .......................................................43
Figure 17. Impacts of Subjective Tax Assessments by ERCA ...............................................43
Figure 18. Length of Appeal Process by Business Sector ......................................................44
Figure 19. Business Complaints about VAT ..........................................................................46
Figure 20. Impacts of VAT on Businesses ............................................................................47
Figure 21. Whether businesses pass on the full amount of VAT to their customers ..............48
Figure 22. Reasons for not being able to pass VAT onto consumers ......................................48
Figure 23. Impacts of Inability to pass on VAT in full to Consumers ....................................49
Figure 24. Opinions on VAT registration threshold .............................................................49
Figure 25. Timely reimbursement of VAT claims, by business sector ..................................50
Figure 26. Impacts of Delays in VAT Refunds .....................................................................51
Figure 27. Tax law impact on investment ............................................................................52
Figure 28. The Impacts of the New Tax Law on Export Development ................................53
Figure 29. The Impacts of the Tax Law on Domestic Industrial Development ......................54
Figure 30. Does Your Business Keep Books of Accounts? ..................................................55
Figure 31. Proposed Measures to Increase Private Sector Capacity .......................................56
### Acronyms and Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>AACCSA</td>
<td>Addis Ababa Chamber of Commerce and Sectoral Associations</td>
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<tr>
<td>BIT</td>
<td>Business Income Tax</td>
</tr>
<tr>
<td>COMESA</td>
<td>Community of Eastern and Southern Africa</td>
</tr>
<tr>
<td>CSA</td>
<td>Central Statistical Agency</td>
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<tr>
<td>EC</td>
<td>Ethiopian Calendar</td>
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<tr>
<td>EPRDF</td>
<td>Ethiopian Peoples’ Revolutionary Democratic Front</td>
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<tr>
<td>ERCA</td>
<td>Ethiopian Revenue and Customs Authority</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FDRE</td>
<td>Federal Democratic Republic of Ethiopia</td>
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<tr>
<td>FGD</td>
<td>Focus Group Discussion</td>
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<tr>
<td>GC</td>
<td>Gregorian Calendar</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GST</td>
<td>Goods and Services Tax</td>
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<tr>
<td>MoFED</td>
<td>Ministry of Finance and Economic Development</td>
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<tr>
<td>PIT</td>
<td>Personal Income Tax</td>
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<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
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<tr>
<td>PSD Hub</td>
<td>Private Sector Development Hub</td>
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<tr>
<td>RFEDB</td>
<td>Regional Finance and Economic Development Bureau</td>
</tr>
<tr>
<td>RRA</td>
<td>Regional Revenue Agencies</td>
</tr>
<tr>
<td>SAP</td>
<td>Structural Adjustment Programme</td>
</tr>
<tr>
<td>SIGTAS</td>
<td>Standard Integrated Government Tax Administration System</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
</tr>
<tr>
<td>TOT</td>
<td>Turnover Tax</td>
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<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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<tr>
<td>VAT</td>
<td>Value Added Tax</td>
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1 Introduction

1.1 Background

Tax reform is one of the major reforms undertaken by the government since the Ethiopian Peoples’ Revolutionary Democratic Front came to power in May 1991. Tax rate and tariff reductions, overhauling the tax system and improving tax administration, and the modernization of the tax structure were among the core elements of the tax reform.

As an element of the reform, in January 2003, Value Added Tax (VAT) was introduced to replace the existing sales tax. VAT has specific characteristics which provide for taxes on services as well as goods, a zero tax rating for exports and allows for reduced (or zero) rates on basic products. It is contended that VAT increases government revenue, improves economic efficiency, promotes exports, and fosters growth.

According to the Ministry of Finance and Economic Development (MoFED), the collection of tax revenue has increased dramatically since the introduction of VAT in January 2003. VAT revenue as a share of total tax revenue reached 41.4 percent in 2007/08. Although the VAT system has been accepted and adopted by businesses there have been many difficulties in its implementation and these have led to complaints from VAT-registered taxpayers.

A major complaint is the perceived market distortion created by VAT, placing VAT-registered businesses at a price disadvantage against non-VAT-registered businesses. Thus, it is argued, VAT-registered businesses are losing their customers to non-VAT-registered businesses, thereby threatening their survival. In addition to this, the high cost to businesses of compliance with the tax laws, especially the VAT laws, is seen as a further threat to businesses.

Other issues raised by the business community are that the tax burden falls disproportionately on a relatively few large, formal enterprises, while large numbers of enterprises remain outside the tax system due to tax evasion, corruption, ineffective tax administration, weaknesses in the structure of the tax system, and tax laws that serve as a strong disincentive to formalization.

Furthermore, there is widespread concern in the business community about the way in which the tax laws have been implemented and the approach to assessment and enforcement of not just VAT but also profit taxes, presumptive tax and excise duties.

It is, therefore, necessary to examine all these concerns regarding the impacts of the reform on business development, with the intention of making recommendations that inform tax policy decision-makers. This study, commissioned by the Private Sector Development (PSD) Hub, aims to do that and thereby to provide valuable input to the process of public-private dialogue.
1.2 Objectives of the Study

The study has an overall objective of assessing the impact of the tax reform on private sector development. This includes reviewing the new tax policy, its impact on business, and making recommendations that would help improve the tax system so that it may contribute to the growth and development of the private sector and hence to the overall economic development of the country. Specific objectives of the study are to:

Conduct an in-depth review and analysis of the reformed tax system and assess its actual or perceived negative or positive impacts on private sector development;
Investigate the tax laws, regulations and implementation directives and identify their weaknesses and discrepancies, and
Recommend measures that address the negative impacts and strengthen the positive elements.

1.3 Methodology

The study has employed a combination of different approaches.

Firstly, a survey of taxpayers, tax practitioners and tax officials based in Addis Ababa was conducted. For the survey, a sample of 299 respondents was interviewed from business enterprises (both VAT-registered and unregistered, lists of which were obtained from the Addis Ababa Revenue Agency and the Ethiopian Revenue and Customs Authority), as well as tax practitioners and tax officials in Addis Ababa. 66 percent of the respondents were VAT-registered businesses, 32 percent were non-VAT-registered businesses while the balance comprised tax officials and practitioners. Moreover, owing to the use of a stratified random sampling technique, all sectors of the economy are represented in the sample.

The collected primary data were edited for consistency, coded, entered into a computer and verified, following which they were analysed. The findings of the survey are presented in the study report in tabular and graphic forms as found appropriate.

Secondly, desk analysis of secondary data such as tax and macroeconomic statistics was undertaken to determine trends pre- and post-reform. International tax data were also examined for purposes of comparison.

Thirdly, a review of tax policy documents and literature was undertaken. In the document review an attempt was made to review tax proclamations issued over time with emphasis on the current tax proclamations, regulations and directives; and identify the weaknesses and discrepancies therein. In the literature review, theoretical and empirical literature was examined to identify both lessons from the experiences of other countries and good practices which could be applicable to Ethiopia.

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1 The target sample size was 300 interviewees.
1.4 Scope of the Study

The coverage of the survey is limited to Addis Ababa. Some 97 percent of the sample frame of the country operates in Addis Ababa; hence conducting a rapid survey on Addis Ababa alone can provide a statistically valid result for the whole country. Moreover, the majority of VAT-registered businesses are located in the capital, Addis Ababa.

It has also been possible to use some results from a previous survey, with a larger sample size and greater geographical spread. It should also be noted here that the results of the two surveys show a high degree of consistency, thus increasing confidence in the validity of the results.
2 Theoretical Basis and Literature Review

2.1 Principles of Taxation and Tax Reforms

The primary purpose of taxation is to mobilize the revenue required to finance public goods and services. Since taxes have a pervasive influence on economic decisions of individuals and businesses, and on social equity, the tax system should achieve the appropriate level of revenue as efficiently and fairly as possible. Thus a well designed tax system should be effective in raising revenue, efficient in its effects on economic decisions of households and businesses, and equitable in its impact on different groups in society.

The commonly accepted principles of taxation are incorporated into most tax reforms, which emphasize:

- Ability to Pay;
- Adequacy;
- Broad Basing;
- Compatibility;
- Earmarking;
- Efficiency;
- Equality;
- Neutrality;
- Non-Retroactivity;
- Predictability;
- Restricted Exemption, and
- Simplicity.

These principles provide a basis for evaluating contemporary tax reforms.

There is a growing body of literature about tax reform documenting the benefits, opportunities and problems, which can, in turn, represent prevention of a particular tax burden for many taxpayers. Tax reforms are based on what are usually referred to as the “Four Rs”:

- Raising revenue,
- Redistribution of wealth,
- Re-pricing to discourage consumption and/or to address externalities, and
- Representation to make clear accountability and good governance.

2.2 Tax Reform Models

Recent tax reforms have tended to focus on achieving broader based taxation at more uniform rates and reductions in the level of tax-induced distortions that are prompted by high rates (Rao). Many tax reforms represent an effort by governments to use tax policy as an instrument to promote investment and development, and to address gender issues as well as assisting disadvantaged groups of society.
A sound tax system has to distribute the tax burden equitably; it should create minimal distortion in economic decision-making; it should correct inefficiencies in the private sector and make tax administration responsive to the problems of tax payers; and it should facilitate economy in the costs of administration and compliance (Vaish and Agarwal).

2.3 Taxation Theory

This section reviews some of the empirical and theoretical literature on taxation, with an emphasis on developing countries, in order to identify important issues relevant to the tax system of Ethiopia. It is not the intention here to be comprehensive in coverage but rather the aim is to highlight the most relevant points and the experience of other countries in tax matters.

Tax policy should be guided by the general principles of neutrality, equity, and simplicity. Recent attempts at tax reform have given due consideration to tax preferences such as incentives, credits, tax reliefs, tax holidays, exemptions, deductions and special treatments. On the other hand, some tax reformists argue that such tax preferences and subsidies may push small businesses into the informal sector due to the exceptional treatment given to large or well connected businesses (Ramalho). Instead, tax credits and investment allowances (with suitable safeguards to minimize dangers), and accelerated depreciation are preferred instruments of advanced tax policies. There is an increasing trend towards the abolition of tax exemptions/privileges from tax laws and their replacement with reduced tax rates or the application of flat tax rates.

Taxes can be levied either on income or expenditure (consumption), or on a combination of the two. One of the major elements of the Ethiopian tax reform has been the introduction of Value-Added Tax (VAT), which is a consumption tax.

2.4 Country experiences

Tax systems are based either on income or consumption or on a hybrid of the two. Income tax reforms are often incremental, bottom-up reforms. Consumption taxation is often proposed as a fundamental tax reform because many proposals would replace the current tax system with an entirely new system. Currently, many countries are moving from income-based tax to greater use of consumption-based tax, and others are adopting the hybrid tax system, depending on the level of their economic development (Cassou and Lansing).

The tax regime forms a critical element of the environment for investment, private sector development and growth. Many developing countries have tax systems that impose a heavy burden on the private sector, forcing firms either to go bankrupt or to go informal or illegal. Overall, the average tax ‘take’ from profits in Sub-Saharan
Africa is estimated at 71 percent, compared with 47 percent in the OECD and 45 percent in South Asia.\(^2\)

Implicit in much of the optimal taxation literature is the assumption that it is costless for individuals and firms to pay their taxes. It is evident, however, that there are substantial individual and firm “compliance costs” from taxation. Even casual economic analysis clearly indicates that one should expect paying taxes to imply incurring costs.

The challenge for governments is to find a way to levy taxes that ensures public revenues while encouraging compliance. How governments raise revenues can make an important difference to business and growth. Faced with a cumbersome tax payment process, high tax rates and low quality of public service delivery, many businesses simply choose to stay informal and not participate. This, in turn, denies government the much-needed revenue. In Burundi’s capital, Bujumbura, the informal sector accounts for more than 75 percent of urban employment. In Kenya, a recent survey shows, there are three times as many employees in the informal sector as in the formal sector (De Ferranti, 2004).

A nation’s tax system is often a reflection of its communal values or the values of those in power. A nation must make choices regarding the distribution of the tax burden—who will pay taxes and how much they will pay—and how the taxes collected will be spent. In democratic nations where the public elects those responsible for establishing the tax system, these choices may reflect the type of community which the public wishes to create. In countries where the public does not have significant influence over the system of taxation, that system may be more of a reflection of the values of those in power. Many countries, both developed and developing, have been working to adjust their tax systems in order to reduce tax impacts and costs, especially for small and medium businesses.

In Ghana, preparation was made to introduce VAT by organizing workshops, discussions and various meetings. After a brief deliberation, a bill introducing VAT was discussed and approved in Parliament in October 1994, but its implementation was deferred until March 1995. Initially the VAT rate was fixed at 17.5 percent. Adopting VAT in Ghana was also related to the country’s desire for accelerated economic growth. Furthermore, VAT has been taken as a vehicle to promote and facilitate the export-development strategy. Moreover, the broadly based VAT has been expected to enhance the stability of revenue and reduce the volatility associated with some of the commodity-based revenues.

The tax system in developing countries needs to be efficient and fair, should raise essential revenue, and should do so without discouraging economic activity. The tax systems in these countries are not expected to deviate much from tax systems in other countries, so as to enable them to integrate into the international economy. Ac-

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\(^2\) World Bank (2010), Paying taxes 2010: the Global Picture [http://www.doingbusiness.org/Explore-Topics/PayingTaxes/](http://www.doingbusiness.org/Explore-Topics/PayingTaxes/) In several countries multiple taxes and poor tax design mean that the total take exceeds profits, e.g. tax amounts to an estimated 235% of profits in the Democratic Republic of Congo (DRC).
According to research studies (Tanzi and Zee) developing countries face the following problems in establishing efficient tax systems.

The majority of the workforce is engaged in subsistence agriculture and in small enterprises or in the informal sector. Most of the operators in these economic activities do not keep accurate records of sales and inventories. As a result, it is difficult to determine the tax base and to raise more revenue and, in many cases, cash income falls below the threshold for tax liability.

It is difficult to build an efficient tax administration due to an absence of research and studies, and a lack of highly-educated and well-trained staff in public finance, tax accounting, tax laws and similar professions.

Taxpayers have limited ability to keep accounts. As a result, governments often take the path of least resistance, developing tax systems that allow them to exploit whatever options are available rather than establishing rational, modern and efficient tax systems.

Lack of statistical data hinders tax authorities in determining the tax level to be generated from the economy, and from which tax type to collect more revenue (coefficient of taxation).

A sound tax system provides the opportunity for real income, saving and investment for accelerated economic growth, and minimizes price distortions that would help reduce the impacts on the private sector development.

Tax compliance costs form an important element in the ease of doing business. Table 1 shows the number of tax payments required to be made annually and the total time required for a number of African countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>No. of payments</th>
<th>Time (hours)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uganda</td>
<td>32</td>
<td>161</td>
</tr>
<tr>
<td>Kenya</td>
<td>41</td>
<td>417</td>
</tr>
<tr>
<td>Burundi</td>
<td>32</td>
<td>160</td>
</tr>
<tr>
<td>Rwanda</td>
<td>34</td>
<td>161</td>
</tr>
<tr>
<td>Tanzania</td>
<td>48</td>
<td>417</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>19</td>
<td>198</td>
</tr>
<tr>
<td>Mauritius</td>
<td>07</td>
<td>161</td>
</tr>
</tbody>
</table>

*Source: World Bank*

- Number of tax payments, which takes into account the method of payment, the frequency of payments and the number of agencies involved in the standardized case study.
- Time, which measures the number of hours per year necessary to prepare and file tax returns and to pay corporate income tax, value added tax, sales tax or goods and service tax, labour taxes and mandatory contributions.
As can be seen, Ethiopia fares quite well in comparison to other countries in the region. It is worth pointing out, however, that Ethiopia is not in competition only with its neighbours and that one of the reasons for the smaller number of tax payments is the absence of any form of labour taxes or social contributions. The time required per payment is high – Uganda, Burundi and Rwanda all manage to make 50 percent more tax payments in less total time than in Ethiopia.

In the study conducted by Richard M. Bird and Eric M. Zolt\(^4\), the actual cost of collecting taxes in developed countries is roughly one percent of tax revenues depending on the types of tax. The internationally accepted standard for collecting $100 ranges from $3 to $6. It is, however, dangerous to calculate collection costs based on annual budgets alone for the very simple reason that there are also fixed/long-term assets used in the process.

Nevertheless, the collection cost for Birr 100 in 1999 E. C. was estimated at Birr 0.217 and in 2000 it was Birr 0.488. This does suggest that the federal revenue operation is still underfinanced, which will tend to push more of the cost of collection onto the private sector and hence increase compliance costs.

The dimensions of the tax burden on businesses matter for investment and growth. A recent study shows that a 10 percent increase in the effective corporate tax rate is associated with a decrease of up to 2 percent in the ratio of investment to GDP and a decrease of about 1 percent in the rate of business entry (WB, 2010).

In order to improve tax administration efficiency, a number of countries have introduced electronic filing and payment system. Angola, Kenya, Mauritius, Mozambique and South Africa all offer electronic tax filing and payment options to businesses. If properly implemented and adopted by businesses, electronic tax systems speed up processing, improve data collection and reduce error rates (WB, 2010). This option is only available where the telecommunications infrastructure is in place to support it.

### 2.5 Value-Added Tax (VAT)

A majority of the countries in the world have introduced VAT, which is a tax on consumption. VAT is usually introduced as a replacement for sales tax and (unlike sales tax, which is charged only to the final consumer) it is levied at all stages in the value chain. Thus, a VAT-registered business pays VAT on the goods and services it purchases as inputs and charges VAT on the output, i.e., goods or services it sells. The difference between the input and output VAT charges is the tax on the value added by the business and this tax is paid over to the government. The business itself (at least in theory) pays no tax but only collects the tax on behalf of the government – one of the reasons for its popularity with governments around the world. In practice, in competitive markets or where there are significant numbers of non-VAT-registered competitors, a business may not be able to pass on all of the VAT to customers and thus part of the cost of the VAT may be borne by the business rather than its customers.

According to dos Santos, an ideal VAT should be applied to the sales of all goods and services. Exemptions should be kept to a minimum to broaden the tax base and to facilitate compliance by taxpayers and control by the tax administration. There should be only one positive rate. Multiple rates make administration more complicated and encourage evasion. Zero rates should be applied exclusively to exports. If they are extended to other sectors it increases the difficulty of control and also increases the number of refund claims. The threshold should be established at a level that, without sacrificing too much revenue, keeps the number of registered taxpayers to manageable levels.

Arguments used against the introduction of VAT are: weakness of the tax administration; absence of a “culture” of issuing invoices by businesses; and a low adult literacy rate. This latter factor can certainly complicate the introduction of taxes such as VAT.

VAT is a transaction-based tax, and consequently should be reported and controlled on a regular basis. Many countries (of which Ethiopia is one) require monthly filing and payment. However, this results in a large number of returns and payments, which the tax administration may struggle to process, and which involve significant work for taxpayers. Thus, some tax administrations have adopted a system of quarterly returns and payment for most taxpayers (dos Santos, 2002).

VAT supporters argue that income tax discriminates against saving by taxing consumption only once but taxing saving more than once, because the income from saving is also taxed. Thus, substituting VAT for income tax should stimulate saving since taxing consumption instead of savings from income would reduce or eliminate that discrimination. Empirical results of a study of OECD countries by Militzer and Ontscherenki found no statistically significant relationship between the introduction of VAT and the domestic savings rate. Though this is not conclusive (as many other economic and social factors were not controlled for in the study) it does suggest that the claimed beneficial effect is at best a very weak one.

The literature asserts clearly that VAT can increase the potential for saving and investment (Price and Porcano, 1992). It is, however, not clear whether the increase in investment would be in the public or the private sector. Some researchers consider VAT as an income-generating machine for the government, hence it is more likely that investment in the public sector would increase after VAT application. Consequently the public sector would be larger than it already is. It is also well recognized in the literature that larger public sector crowds out private investments.

Militzer and Ontscherenki argue that although VAT is a consumption tax, in practice some of the cost is likely to fall directly on business. It is a tax purely on consumption only when businesses are able to shift the tax fully on to the final consumers in the price of their products. If businesses are unable to do this, it reduces their profit margins and, in consequence, this may hinder the growth of the private sector.

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5 Dos Santos, Paulo, 2002, VAT Introduction – Administrative Issues
7 Ibid
8 Militzer, K. and Ontscherenki, I. (1990), The Value-Added Tax: its impact on saving
A VAT system provides for rebates on exported goods and it is therefore expected to stimulate exports. It also adds to the price of imported goods and consequently reduces the imports of the country. The practical impact of VAT on exports and imports is, however, mitigated to a large extent by currency fluctuations where currencies are freely floating. Where the exchange rate is managed, as in Ethiopia, the impact of VAT may be more visible.

An important rationale for the original adoption of VAT in Europe was to facilitate trade by turning the then existing sales taxes into true destination-based consumption taxes both by ‘untaxing’ exports (and removing hidden subsidies) and by placing the taxation of imports and domestic production on a level playing field. While the theoretical necessity for this step in a world of at least imperfectly flexible exchange rates is still debated by some, on the whole VAT’s effects on trade have been considered to be largely beneficial, with economists applauding the level playing field for imports and governments generally paying more attention to the removal of barriers to exports.

Recently, however, some (Desai and Hines 2002) have suggested that VAT may actually contribute to deterring rather than facilitating trade in developing and transition economies. In order to understand their reasoning, however, it is worth quoting from their conclusions in this regard.

“The reasons that VATs impede international trade is that they tend to be imposed most heavily on traded sectors of economies, governments often fail to provide adequate VAT rebates for exports, VATs replace other taxes that may influence trade, and VATs encourage the growth of government. Governments contemplating the introduction or expansion of VAT use have it within their powers to address all of these issues, if they so choose; what the data reflect are average results of past policies. The results suggest that VAT practice differs markedly from VAT theory, and point to the potential salutary effects of reforming VAT administration in countries around the world.” (Emphasis added.)

Analysts have also recently begun to discuss the implications for VAT of the considerably larger underground or shadow economies found in developing and transition economies compared to developed countries. Some analysts suggest that in the presence of a substantial ‘informal’ sector, a tax like VAT that falls on the formal sector acts to deter the growth and development of the economy as a whole. Indeed, one study by Hines (2004) concludes that increasing consumption taxes definitely fosters the expansion of the hidden economy if (as seems plausible) the labour-intensity of production in that sector is greater than in the formal sector. Yet another study suggests that even governments aware of such problems may have nonetheless chosen to impose higher taxes, including VAT, on the formal sector of the economy because with their relatively weak tax administrations the best way for them to raise revenue

10 Emran, M. S., and Stiglitz, J. E., 2005, On Selective Indirect Tax Reform in Developing Countries
may be to increase barriers to entry to the formal sector, thus creating ‘rents’ that may then be taxed (Aurioll and Walters, 2003 as quoted in Richard M. Bird (2005)).

Many businesses in developing economies operate in both the formal and informal sectors at the same time. Although firms operating in the shadow economy may escape VAT liability on their sales they are also not able to reclaim credit for any VAT paid on inputs. For this reason, it has often been suggested that one way to impose an appropriate tax burden on those in the informal sector is precisely through a VAT. On the other hand, as noted earlier, others have argued that increasing taxation of the formal sector may expand, not reduce, the amount of hidden economic activity. The findings of the survey covered later in this report suggest that, in Ethiopia, this latter effect is being experienced, though as much because of the tax enforcement regime as the tax rates themselves.

There are many papers and studies on the costs that Value Added Tax places on business. Sandford et al (1989), for instance, laid out three separate categories of compliance costs: (1) the **fiscal costs** associated with establishing and registering a company, the employee costs of running day-to-day VAT accounting, the cost of expertise to understand and keep up with changes in policies and rates, the cost of submitting VAT returns, and the cost of external accountants for operational and advisory services; (2) the **costs of the time** of senior management in overseeing the function; and (3) the **psychological costs** caused by the onus being on the business to conduct their VAT affairs properly, with financial and civil/criminal sanctions for failing to do so.

Several studies\(^{11}\) have been undertaken into compliance costs and these have consistently shown their highly regressive nature; the financial cost to small businesses as a proportion of their turnover is typically between ten and one hundred times greater than the cost to large businesses. This applies to all taxes but can be an especially acute problem in the case of VAT. In recognition of this, many tax jurisdictions have introduced simplified procedures for smaller businesses.

One of the elements of practical administration of a VAT system which gives rise to complaints from business, and which is highlighted by Desai and Hines, is slow refunds of VAT credits by government. This factor is prominent in the surveys of businesses conducted for this study.

As an example of how some other countries administer VAT refunds, Grenada’s experience is as follows. A credit exists where a registrant’s input tax for the month exceeds the output tax for that month. With the exception of exports, the difference will be carried forward to the next month and will be treated as a deductible input credit for that month. Further excesses will be carried forward consecutively for a maximum of three months or the registrant may ask that the amount be applied to

\(^{11}\) See, for example:
ATAX University New South-Wales, Tax compliance costs of New Zealand small and medium sized businesses, 2006
Sandford et. al, Administrative and Compliance Costs of Taxation, 1989
another tax type where a liability exists. If, after three months, excess credit remains, the registrant may request a refund. If the refund is not paid within two months of the application, it will attract interest at a rate of 1.5 percent per month (Government of Grenada, 2009).

2.6 Lessons from Tax Reforms

Developing countries are more prone than developed countries to having complete exemption from profit (and other) taxes of certain sectors in a way that emphasizes the state’s role in resource allocation. Such practices, however, are clearly detrimental to the proper functioning of market forces.

Many developing countries design incoherent depreciation systems. Allowable depreciation of physical assets for tax purposes is an important structural element in determining the cost of capital and the profitability of investment.

The most common shortcomings found in the depreciation systems in developing countries include too many asset categories and depreciation rates, excessively low depreciation rates, and a structure of depreciation rates that is not in accordance with the relative obsolescence rates of different asset categories. Rectifying these shortcomings should receive a high priority in tax policy deliberations in these countries. The Ethiopian tax framework seems to have avoided these pitfalls and has a clear and logical depreciation system.

A brief summary of lessons from the experience of other countries in tax reform is presented below:

- The tax reform process must be well coordinated.
- Tax reform must take into account the initial conditions at home and abroad.
- Attention has to be paid to the preparation and analysis of reforms, with broad consultation, providing a reasonable period of adjustment prior to implementation and ensuring consistency of the reform measures.
- Changes in tax system must be presented as part of longer term strategy to improve the public sector environment for the private sector.
- The base of existing taxes should be broadened. Base broadening can increase revenues and improve the simplicity, neutrality and equity of the tax system.
- The use of the tax system for special tax preferences/incentives should be approached with great care, in order to avoid unintended consequences and/or abuse.
- The self-assessment procedure should be encouraged to increase compliance.
- Persuasion of taxpayers should take precedence over coercion. The majority of taxpayers are willing to comply voluntarily but may require help. Strong
enforcement measures (litigation, search and seizure, penalties, interest on uncollected tax, etc.) should be reserved for cases of severe malpractice.

- Take severe action when deliberate tax evasion is detected.

Few of these lessons seem to have been taken into account in the reform of the Ethiopian tax system.
3 Evolution of Ethiopian Tax Reforms and Review of the Current Tax Laws

3.1 Evolution of the Tax Reforms

Tax laws change with political regimes. During the Imperial regime, the tax law was made compatible with the system. During the Derg regime, the tax laws were revised and made to conform with the guiding ideology and were instrumental in suppressing private sector development in favour of the collective public sector. Under the current regime, a number of tax reforms have been made.

The basis for a modern tax system in Ethiopia was laid down with the promulgation of Proclamation No. 173/1961. This was the most frequently cited income tax law until the third of July 2002.

During the Derg regime reforms were introduced to some of the imperial tax laws. The regime issued separate proclamations related to Rental tax; Excise and Sales Tax; Service Tax; Capital Gains Tax; and Stamp Duty. These reforms were intended to align the laws with the regime’s ideology.

When the EPRDF came to power in 1991, income tax rates were reduced both to encourage individuals to work more and to address issues of vertical equity. For example, until 1992, the maximum employment tax rate was 85 percent at a graduating level above the threshold of Birr 50 monthly. In 1992 the highest tax rate was reduced to 50 percent while the threshold was raised to Birr 105 monthly. The highest rate was subsequently further reduced to 35 percent and the threshold level raised to Birr 120 monthly.

The business income tax rate was reduced from 89 percent to 59 percent in 1990; and then to 40 percent in 1995. In 1996 the rate was further reduced to 35 percent so as to encourage business development.

The dividend tax rate was 25 percent until 1992. Then it decreased to 10 percent so as to encourage private sector participation in share companies. Royalties were taxed at 40 percent, later reduced to the current rate of 5 percent. This has encouraged sectors that make royalty payments, particularly the mineral extraction sector.

The story is similar for other taxes and duties, which have in general been reduced during the twenty-year reign of the EPRDF.

The Constitution of the Federal Democratic Republic of Ethiopia (FDRE), prescribes the powers of the Federal Government and the Regional States in articles 96 and 97 respectively, setting detailed tax types and sources of taxation. The provisions for joint power of taxation, undefined area of tax matters and issuance of directives, and in exercising their mandates is stipulated in articles 98 to100. Fiscal policy in Ethiopia is confined to the federal level but tax legislation can be enacted at both federal and state levels.
Since the coming to power of the EPRDF, tax reform has gone through several stages. The first stage (1992/93-1995/96) took the form of piecemeal changes. The second stage of the tax reform programme (1996/97-2000/01) was expanded in scale and breadth, and brought major changes in the tax system. The third stage (2001/02-2005/2006) was the period for implementation of the studies undertaken during the second stage and improvement in the tax administration. The fourth stage (2006/07 on) has introduced SIGTAS (Standard Integrated Government Tax Administration System), and Business Process Re-engineering (BPR) as part of the efforts to enhance the efficiency of the tax administration.

The recent tax administration reforms include the issuance of a unique identification number known as a TIN (Taxpayer Identification Number). Every person having a tax obligation is required to obtain a TIN. In order to address the problems in the implementation of TIN where a single person could have multiple TIN numbers, the tax authority introduced a biometric fingerprint system so as to deter taxpayers from having multiple TINs.

The following section reviews the current tax laws in detail.

### 3.2 Current Ethiopian Tax Laws

#### 3.2.1 Taxes on income and profits

Proclamation No. 608/2008 amends the earlier income tax proclamation No. 286/2002. The amendment includes the change of name of the federal tax authority to the Ethiopian Revenues and Customs Authority (ERCA); it also allows deduction of the actual amount of maintenance and improvement expenses of a business asset. The additional articles focus mainly on the various penalties for failure to meet the requirements of the use of a sales register machine by registered businesses.\(^12\)

**Income Tax on Employment**

This is tax on income from employment including, without limitations, salaries, wages, allowances, directors’ fees, and other personal emoluments. Tax is withheld by employers and reported to the tax authority every month.

According to the proclamation, the first Birr 150 of monthly income should be deducted prior to the calculation of the tax. The top marginal tax rate is 35 percent, levied on income exceeding Birr 5,000 per month.

**Taxes on Income from rental of buildings**

Tax on income derived from the rent of houses or office buildings, manufacturing plants, materials and goods, etc. The tax is computed on the basis of annual rent income after deducting allowable expenses. The following amounts shall be deducted from income in computing taxable income:

\(^{12}\) Federal Negarit Gazeta 15th year no. 15 Addis Ababa 9th January 2009
• taxes paid with respect to the land and buildings being leased; except income taxes;
• for taxpayers not maintaining books of accounts, one fifth of the gross income received as rent for buildings, furniture and equipment as an allowance for repairs, maintenance and depreciation of such buildings, furniture and equipment;
• for taxpayers maintaining books of accounts, the expenses incurred in earning, securing and maintaining rental income, to the extent that the expenses can be proven by the taxpayer and subject to the limitations specified by the Proclamation; deductible expenses include (but are not limited to) the cost of lease (rent) of land, repairs, maintenance, and depreciation of buildings, furniture and equipment in accordance with Article 23 of the Proclamation as well as interest on bank loans and insurance premiums.
• The first Birr 1,800 of annual income should be deducted prior to the calculation of the tax.
• Incorporated businesses: The tax rate is 30 percent of taxable income.
• Unincorporated Persons: The tax is progressive up to a maximum rate of 35 percent for taxable income of Birr 60,000 and above per year.

**Tax on business and other profits**

The tax is imposed on the taxable business income realized from entrepreneurial activity. The taxable income is determined per tax period on the basis of the profit and loss account or income statement, which shall be drawn in compliance with Generally Accepted Accounting Standards, subject to the provisions of the Proclamation and directives issued by the Tax Authority.

The first Birr 1,800 of annual income should be deducted prior to the calculation of the tax. Some categories of income are exempt from business income tax (see the proclamation for detail). The tax rates are:

- Unincorporated businesses: The tax rate is progressive. The maximum rate is 35 percent for taxable income above Birr 60,000 per year.
- Incorporated business: The tax rate applied is 30 percent on taxable income.

**Taxes on Other Incomes**

**Income Tax on Royalties**

A royalty is a payment of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematography films and films or tapes for radio or television broadcasting, any patent, trade work, design or model, plan, secret formula or process, or for the use or for the right to use of any industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The Withholding Agent who effects payment shall withhold the foregoing tax and account to the Tax Author-
ity within the time limit set out in the Proclamation. The applied tax rate is 5 percent on income earned from Royalties.

**Income tax on Income from Rendering of Technical Services**

Tax liable on all payments obtained in consideration of any kind of technical services rendered outside Ethiopia to resident persons in any form. Where “Technical service” means any kind of expert advice or technological service rendered. No deductions or exemptions will be allowed in such services. The tax rate is 10 percent of the payment made.

**Dividends**

Tax on income derived from dividends from a share company or withdrawals of profits from a private limited company. The Withholding Agent shall withhold or collect the tax and account to the Tax Authority. No deductions or exemptions will be made. The tax rate is 10 percent of the payment made.

**Tax on Interest Income on Deposits**

Tax on income derived from interest on deposits. The payer shall withhold the tax and account to the Tax Authority. No deductions or exemptions will be made. The tax rate is 10 percent of the payment made.

**Tax on the Gain on the Transfer of Certain Investment Property**

Income tax on gains obtained from the transfer (sale or gift) of property. Gains obtained from the transfer of a building held for residence is exempt. The following rates are levied: (a) 15 percent for buildings held for a business, factory or office; (b) 30 percent for shares of companies.

### 3.2.2 Taxes on Goods and Services

**Excise tax Proclamation No. 307/2002 amended by Proclamation No. 610/2008**

These proclamations provide for levying taxes on goods imported and produced locally as stated in the attached schedule. The amendment is concerned only with a few articles of the law. The basic essential elements are embodied, because of the tax’s selective nature and purpose to repeal.

Excise tax is levied on a selected list of locally produced and imported goods (see Annex A1 for the schedule). The tax base is the cost of production for goods produced locally and CIF value plus customs duty for imported goods. The tax is collected within thirty days from the date of production for locally produced goods and at the time of clearing the goods from Customs for imported goods. However, if the taxpayer requests permission to deposit goods produced in a bonded warehouse without payment of tax and if the request is approved by the Tax Authority the payment of the tax on such goods so deposited shall be effected at the time they are removed from the bonded warehouse.
Value Added Tax (VAT) Proclamation No.285/2002

VAT is levied on locally produced goods at the manufacturing level or on imported goods at the import gate. The bases for taxation are the producer’s wholesale price plus excise tax for local goods or the CIF value plus customs duty and excise tax for imports. There is a refund for input taxes paid on raw materials used in the production of local goods, except for pure alcohol used as raw material. The tax is payable monthly and is due no later than the end of the following month. For imported goods, the tax is collected at the same time as the customs duty.

Some taxable supplies of goods or rendering of services are exempted (these are detailed in the proclamation). A few transactions are zero rated but these are very limited: exports; international transport; supply of gold to the National Bank; or sale of a business as a going concern. All other goods and services are liable to VAT at a rate of 15 percent. See Annex A2 for further details.

TOT on Services rendered locally

Turnover tax is levied on services rendered locally. It is intended to be equivalent to VAT for non-VAT-registered entities. Turnover tax proclamation No. 611/2008 repeals and replaces some articles of turnover tax proclamation No. 308/2002.

TOT is charged at two rates:
- 2 percent on Contractors, grain mills, tractors and combine-harvesters, and
- 10 percent on other services.

3.2.3 Taxes on International Trade

Taxes on Imports

Customs Duty Tariff Regulation 80/2002 amended by customs proclamation 622/2009

The customs tariff applies to all imports. There are exemptions for different organizations and items (detailed in the regulation and summarised in Annex A). Items are classified according to a schedule of 97 chapters, based on the Harmonized System of Tariffs Classification Code. Customs duty has 6 bands which are applied to imported goods. The regular tariff bands are 0, 5, 10, 20, 30, and 35 percent. However, as Ethiopia is a member of COMESA, tariffs applied to imports from other member states are reduced by 10 percent from the normal levels.

Import Excise Taxes

Levied on selected imported goods, the basis for the taxation is the CIF value plus the customs duty. Tax ranging from 10-100 percent of the value is applied on selected items.
Import Value Added Tax

VAT is levied on imports at the standard rate; the basis for the taxation is the CIF value plus the customs duty and excise tax.

Taxes on Exports

All export duties and taxes have been abolished on all products except for animal skins. There is a 150 percent export tax on wet blue skin of cattle, wet blue hides of sheep and goats, and pickled hides of sheep. The tax was introduced on 1st January 2010 and is intended to act as a disincentive to the export of unfinished leather and leather products (and thus to encourage local addition of value). It is perhaps no coincidence that leather exports have fallen significantly since the imposition of this tax.

A duty draw back and duty free import schemes have been introduced. Under the duty drawback scheme, goods produced for export, re-export or imported raw materials are subject to refund of duty paid. Ninety-five percent of the duty drawn back is refunded for raw materials or commodities if re-exported and 100 percent if exported after being processed or used for packing or containing. Under the duty free import scheme, persons or organizations wholly engaged in supplying their products to foreign markets are allowed a duty free purchase of local or imported raw material for their production; in order to qualify, the product should be exported within one year of the purchase of such raw materials.

3.2.4 Other taxes


Use of stamped paper is obligatory for many legal documents, such as contracts or papers in court proceedings, property titles, power of attorney, notary acts, etc. A duty is levied on all such documents.

Stamp duties are not levied, however, on documents where the Ethiopian government or foreign embassies, consulates, etc., would be the party subject to duty. The duty varies according to the type of document and value of transaction.

Withholding tax: Current payments of income tax at time goods are imported. Proclamation 227/2001

Tax collected at the time of import of goods for commercial use, where the collected tax is treated as a withheld tax credited against the tax payer. The withholding rate is three percent.
**Income tax: Withholding of income tax on payments. Proclamation 227/2001.**

Category “A” taxpayers, government agencies, private non-profit institutions and NGOs withhold income tax on payments made to persons within categories specified in regulation No.75/2001. The withholding tax rate is two percent.

### 3.3 Examination of Tax Laws, Regulations and Implementation Directives

Although the aims of the tax reforms have been clear, it is fair to say that these aims have not been fully achieved in practice. In this section, an attempt is made to identify the weaknesses of the tax laws in force and to highlight discrepancies between the tax laws, regulations and implementation directives.

#### 3.3.1 General Observations

Generally speaking, the tax reforms were not preceded by the sort of comprehensive studies and national consultation with stakeholders, especially the business community, that might be expected. As a result, a number of problems have arisen in the implementation of the tax reforms, to the detriment of both government and taxpayers.

There is no comprehensive guidance on the implementation of the tax proclamations to serve the tax authority and taxpayers in ensuring uniform implementation of the law within the tax jurisdiction. Moreover, there is always a considerable time lag between the issuance of a tax proclamation and detailed implementation directives, thereby leaving room for subjectivity in tax assessment. Tax implementation directives are not readily accessible and available to taxpayers. Improving the availability of these documents would increase the transparency of the system and hence reduce the potential for confusion or malpractice.

Examination of the tax proclamations, regulations and directives shows the presence of several ambiguities and areas which lack clarity in the laws (detailed below), thereby making understanding of the laws difficult even for tax professionals, let alone the average taxpayer.

#### 3.3.2 Specific Issues

- Gains on transfer of certain investment and capital assets are determined under Article 37 of Proclamation No. 286/2002. The law makes no provision, however, for any capital loss that might occur. This omission should be rectified.

- The tax levied on rent for office use is greater than the rental tax imposed on buildings for residential and related use. This acts as a disincentive to the growth of business activities and self-employment, particularly when coupled with the shortage of space, which is especially acute in Addis Ababa.
• Although the VAT legislation allows for refunds to be made to (mainly) exporters within two months from the time applications are lodged, the actual time taken for refunds is, according to the survey results, frequently considerably longer than this. This is unacceptable. For ERCA to have credibility with taxpayers it must treat them as it wishes to be treated itself.

• The VAT reporting period of one month is significant problem for businesses, especially those which have multiple branches operating in different parts of the country. For all businesses, but especially multi-site firms, gathering documents from the different branches so frequently imposes considerable compliance costs. In contrast, the UK, for example, with vastly better infrastructure provision, generally operates a three-month reporting period for VAT returns.

• It is normal for many sales among businesses in Ethiopia, especially between wholesaler and retailer, to be made on a credit basis. Businesses extend credits which they may not collect within a month. However, creditors, wholesalers, are obliged to pay taxes that they have not yet collected from their customers. That is, non-cash-based businesses have to pay the VAT on their sales before their customers pay them. This can have very severe cash flow implications for businesses and may force some out of business. Once again, in some countries, businesses with turnover below a certain level may opt to pay VAT on a cash basis rather than an invoice basis, subject to keeping adequate records of their transactions. Such an option is not available in Ethiopia.

• According to the tax implementation directives, when input tax exceeds output tax, a taxpayer may be allowed to carry the credit forward and a refund is made after five months if input tax still exceeds output tax. The tax law stipulates, however, that tax credits will be refunded immediately. Five months is too long a time and such a lopsided system only serves to increase taxpayer cynicism about the tax authorities, as well as being contrary to the law.

• If the taxable turnover of an enterprise exceeds Birr 500,000, it is obliged by law to register for VAT. There is an argument that turnover related to supplies classified in the law as exempt should be excluded from this calculation.

• According to the implementation directives, voluntary registration is at the discretion of ERCA and enterprises must be regularly supplying or rendering at least 75 percent of their goods/services to VAT-registered businesses. However, the law states that registration is voluntary, and any business should be able to register for VAT if it wishes to do so.

• According to the VAT implementation Directives issued on 10th February 2010 by MoFED, effective 10th March 2010, government organizations and public enterprises making purchases that exceed Birr 5,000 should withhold the VAT due to the supplier and pay this directly to the tax authority instead. This complicates the already slow refund system and should not be necessary. If the public organization keeps adequate records, it is surely a brave and foolish businessman who attempts to avoid paying the VAT due on such a transaction.
• Currently, there are no lists of specific businesses that should use sales register machines in the proclamation. The practice on the ground is that all VAT-registered businesses should buy and use such equipment and should prepare a daily report, irrespective of the nature of the business. It should be clear that such an approach is not appropriate for many businesses, where invoices may only be issued on a weekly or monthly basis, and is an unnecessary burden on business.

• According to the VAT proclamation, it is administrative feasibility considerations that limit the registration of businesses for the Value-Added Tax to those with annual taxable transactions value exceeding Birr 500,000. Although this is a valid approach, the high level of the threshold creates considerable scope for market distortion and unequal competition between VAT-registered and non-registered businesses and a lower threshold could increase both revenue and equity of the system.

• There is no mechanism in place that would help to identify businesses’ annual turnover and compel them to register for VAT. Instead, the VAT registration is left to businesses’ self-assessment and decision. In reality, however, there are significant numbers of eligible businesses which remain outside the VAT net. Hence, the tax authority has to prepare an indicator that would enable it to decide which businesses should come within the VAT net. It might well be the case that greater concentration on increasing registration would generate greater revenue than pursuit of those suspected of small-scale VAT fraud.

• TOT is intended to be an equalization tax imposed on businesses not registered for VAT which enhances fairness in commercial relations and broadens the coverage of the tax system. However, there are strong indications from the surveys of businesses that the equalization aim stated in the proclamation is not being realized in practice.

• For the purpose of imported goods valuation, the customs proclamation urges the use of a valuation CD which is prepared and distributed to business communities. It seems, however, that practical implementation differs markedly from this, and the current CD is three years old. This can lead to arbitrary valuations and creates uncertainty and scope for corrupt practices.

• In order to deal with mixed supply (taxable and exempt) as well as capital expansion issues, the tax authority issued Directive No.20/2009. With regard to the refund of VAT paid on mixed supply, a formula is provided in the directive. However, the directive fails to give a concrete ruling on the different results of the calculation and says that if the calculation gives points greater than 90 percent, all taxes paid on domestic purchases or imports should be deducted. What if the calculation is less than 90 percent? Why should the tax not be levied exactly in proportion to the results of the calculation?

• Directive No.20/2009 considers any business expansion as an independent entity and does not allow a VAT-registered business to deduct the VAT paid on inputs that are used for investment expansion from VAT collected from the existing
business and hints that it will settle input taxes once the expansion starts generating income. If the expansion is the same legal entity then it should be treated as such by the tax authorities. This directive acts as an extra tax on business expansion and works against the tax incentive offered towards expanding investments.
4 Recent Macroeconomic and Government Revenue Performances

4.1 Recent Macroeconomic Performance

The Ethiopian economy has continued to register impressive growth since 2003/04. According to the Ministry of Finance and Economic Development (MoFED), the economy averaged real GDP growth of 11.5 percent over the period 2003/04-2008/09. This impressive growth is attributed to growth in the service sector averaging 13 percent, the industrial sector averaging 10.3 percent and the agricultural sector 10.8 percent over this period.

Despite the dramatic economic growth, the structure of the economy has remained more or less the same, with agriculture still dominating the other sectors and industry failing to increase its share of GDP as planned. According to MoFED, the share of the agricultural sector in GDP declined slightly to 43.2 percent in 2008/09 while the service sector achieved a 45.1 percent share in the same year, with industry making up the balance (12.7 percent). Ethiopia’s development strategy envisages transformation from agriculture to industry and services but the performance of industry remains below expectations. It is at least arguable that the tax system bears some part of the responsibility for this.

Ethiopia is a foreign exchange constrained country, where export receipts barely cover the oil import bill. The country’s exports are dominated by a few primary agricultural commodities. Export earnings have surged from Birr 5.2 billion in 2003/04 to Birr 13.6 billion in 2007/08, an average annual growth rate of 27.2 percent over the five-year period (National Bank of Ethiopia). The surge in global commodity prices before the 2008 financial crisis contributed to this impressive growth rate. The value of all major export items witnessed significant positive growth over the five years.

Ethiopia imports a range of essential goods. According to NBE, merchandise imports have shown persistent growth over the last five years, from Birr 22.3 billion in 2002/03 to Birr 58.5 billion in 2007/08, an average annual growth rate of 30 percent. The trade balance has therefore remained in large deficit. The increasing level of imports, however, has contributed to increasing the tax revenue collected by the government.

Inflation in Ethiopia has historically been correlated with the success of the harvest: in good years, prices have fallen and they have risen in bad years. In the last few years, however, there has been an unprecedented sharp rise in the prices of goods during a period when significant growth in both agricultural and non-agricultural output has been recorded. In 2006/07 and 2007/08, for example, the annual inflation rate reached 17.1 percent and 25.4 percent respectively (CSA). This effect has been attributed to a number of factors, including high domestic credit, increased aggregate demand, and structural changes in the economy, with farmers shifting to cash crop production. Government measures, such as raising the reserve requirement of banks,
reducing credit to the construction sector, wheat rationing, etc., have successfully reined back inflation to manageable levels.

4.2 Government Revenue and Expenditure

Governments generate much of their revenue from tax. Ethiopian general government revenue including external grants increased from Birr 13.6 billion in 2002/03 to Birr 39.7 billion in 2007/08, an average annual increase of 24.1 percent over the period.

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<th>2002/03</th>
<th>2003/04</th>
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<td>65.5</td>
<td>70.1</td>
<td>70.5</td>
<td>68.9</td>
</tr>
<tr>
<td>Share in GDP</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Revenue</td>
<td>9.9</td>
<td>9.4</td>
<td>8.2</td>
<td>7.0</td>
<td>10.3</td>
<td>9.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Finance and Economic Development and own calculation

Tax revenue, which constitutes more than 79 percent of domestic revenue, grew, on average, by 23.9 percent in the period 2003/04-2007/08 to reach Birr 23.8 billion in 2007/08. Tax revenue comprises direct tax and Indirect taxes. Indirect tax includes customs duties, excise taxes and VAT. One indicator of the state of development of a country is the share of direct tax in total tax revenue; as a country develops, the capacity of the tax authorities to collect taxes directly generally improves, hence the share of direct taxes rises. In Ethiopia statistics show the contrary trend. The share of direct taxes decreased from 36.5 percent in 2002/03 to 29.5 percent in 2007/08 while the share of indirect tax increased from 63.5 percent in 2002/03 to 70.5 percent in 2007/08 (see Table 2 above).
Although revenue performance seems promising in absolute terms, it has not significantly increased as a share of GDP. Tax revenue fell from 9.9 percent of GDP in 2003/04 to 7 percent in 2006/07 but improved in 2007/08 to reach 10.3 percent. This shows that government revenue performance has not been growing in tandem with the growth of the economy. This in turn is mainly because, in spite of agriculture’s contribution of more than 45 percent of the GDP, it generates a negligible level of tax revenue for the government, as Table 3 shows.

According to MoFED, total expenditure increased from Birr 19.4 billion in 2003/04 to Birr 46.9 billion in 2007/08, an average annual growth rate of 23.7 percent. Although government revenue and grants rose by 35 percent in 2007/08, total income fell short of financing government expenditure. As a result, the budget deficit in 2007/08 was Birr 7.2 billion (3.8 percent of GDP). Excluding grants, the deficit was Birr 17 billion (7.5 percent of GDP). The government financed the deficit mainly through domestic borrowing.

4.2.1 Analysis of Pre- and Post-2003 Revenue Performance

Tax revenue was rising even in the pre-reform period, hence it is difficult to say with any certainty that the reform has been responsible for the increased share of total revenue formed by tax. What is definitely significant, however, is the increased contribution of indirect taxes to the total tax take. This increase is almost certainly attributable to the introduction of VAT.

It is likely that, in the medium term, the move to join the WTO and the COMESA FTA will lead to downward pressure on customs tariffs, which form a significant source of revenue for the Government of Ethiopia. In order to maintain revenue levels, government will have to generate greater tax revenue from domestic sources to compensate for the likely tariff revenue losses. In the pre-reform period, foreign trade sources accounted for, on average, 67.8 percent of indirect tax revenues. Contrary to expectations, post reform, this share has barely changed, in fact increasing slightly to an average of 68.8 percent. This shows the difficulty faced by the tax system in shifting towards domestic sources of revenue.
Table 3. General Government Revenue

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Revenue</td>
<td>5,416</td>
<td>6,285</td>
<td>7,200</td>
<td>7,787</td>
<td>8,111</td>
<td>10,520</td>
<td>12,398</td>
<td>14,800</td>
<td>17,372</td>
<td>23,800</td>
</tr>
<tr>
<td>Direct income tax</td>
<td>1,834</td>
<td>2,169</td>
<td>2,495</td>
<td>2,980</td>
<td>2,878</td>
<td>3,132</td>
<td>3,930</td>
<td>5,102</td>
<td>5,186</td>
<td>7,015</td>
</tr>
<tr>
<td>Business Profits</td>
<td>1,175</td>
<td>1,358</td>
<td>1,457</td>
<td>1,679</td>
<td>1,639</td>
<td>1,303</td>
<td>1,714</td>
<td>1,741</td>
<td>2,305</td>
<td>3,040</td>
</tr>
<tr>
<td>Agriculture Income</td>
<td>113</td>
<td>118</td>
<td>121</td>
<td>130</td>
<td>72</td>
<td>138</td>
<td>150</td>
<td>82</td>
<td>98</td>
<td>136</td>
</tr>
<tr>
<td>Indirect Tax</td>
<td>3,583</td>
<td>4,115.8</td>
<td>4,705</td>
<td>4,807</td>
<td>5,233</td>
<td>7,388</td>
<td>8,466</td>
<td>9,698</td>
<td>12,186</td>
<td>16,785</td>
</tr>
<tr>
<td>GDP at current basic prices</td>
<td>57,368</td>
<td>62,299</td>
<td>63,069</td>
<td>61,779</td>
<td>68,204</td>
<td>79,185</td>
<td>98,006</td>
<td>121,943</td>
<td>159,803</td>
<td>231,820</td>
</tr>
<tr>
<td>GDP Agriculture</td>
<td>25,398</td>
<td>31,049</td>
<td>30,039</td>
<td>26,855</td>
<td>28,560</td>
<td>34,951</td>
<td>45,710</td>
<td>58,369</td>
<td>75,802</td>
<td>117,004</td>
</tr>
</tbody>
</table>

Share in %

| Business profit/direct tax | 64.1  | 62.6  | 58.4  | 56.3  | 56.9  | 41.6  | 43.6  | 34.1  | 44.5  | 43.3  |
| Agriculture/direct income  | 6.2   | 5.4   | 4.8   | 4.4   | 2.5   | 4.4   | 3.8   | 1.6   | 1.9   | 1.9   |
| Domestic indirect/indirect tax | 33.6  | 35.0  | 29.4  | 31.2  | 31.9  | 28.6  | 32.1  | 32.1  | 32.8  | 30.3  |
| Foreign trade/indirect tax | 66.4  | 65.0  | 70.6  | 68.8  | 68.1  | 71.4  | 67.9  | 67.9  | 67.2  | 69.7  |

Share of GDP

| Direct income tax | 3.20  | 3.48  | 3.96  | 4.82  | 4.22  | 3.96  | 4.01  | 4.18  | 3.25  | 3.03  |
| Indirect Tax     | 6.25  | 6.61  | 7.46  | 7.78  | 7.67  | 9.33  | 8.64  | 7.95  | 7.63  | 7.24  |
| Agriculture tax/Agriculture GDP | 0.45  | 0.38  | 0.40  | 0.48  | 0.25  | 0.39  | 0.33  | 0.14  | 0.13  | 0.12  |

Source: MoFED and own calculation

As shown in Table 2, the share of agricultural income tax in the total direct tax has been declining steadily over time since 1998/99, falling by an average of 0.4 percent per annum. Thus, in spite of the continued growth of agricultural output, the contribution of the sector to government revenues has remained pitifully low. Indeed, Table 2 also shows that the agriculture sector paid only 1.2 percent of its gross product in taxes in 2007/08.
Although the absolute amount of tax collected during the post-2003 period is higher than that pre-2003, the percentage in proportion to GDP has fallen. However, the tax burden on private sector non-agricultural businesses has, though fluctuating, risen overall – a sharp contrast to the situation of agriculture. These figures suggest that one of the main impacts of the tax reforms has been that the tax administration has concentrated its tax collection efforts primarily on the most visible, easiest to tax section of the economy. Whilst this may be good for revenue generation in the short term, it may have less desirable long term effects.

Figure 1. Tax revenue and Tax burdens on agriculture/non-agriculture sectors

Formal big businesses have been complaining about the disproportionate tax burden on them. Their argument is that significant contributors to the economy, i.e., the agricultural and the informal sectors, are not generating tax revenues whilst they are being squeezed ever harder. Figure 1 highlights the disparity between the tax burdens on the agricultural and non-agricultural sectors. Note that a separate axis has been required in order to show the agriculture sector adequately.

The other business activities which are not generating tax revenue despite constituting a significant share of economic activity are those of the informal sector. The informal sector accounts for the majority of employment in Ethiopia – according to the CSA’s 2005 labour force survey report\textsuperscript{13}, the informal sector represents 71 percent of urban employment and 81 percent of youth employment. Several sectors are almost exclusively informal (at least as measured by the number of employees in the sector). These include domestic work, wholesale and retail trade, hotels and restaurants, and primary production. Manufacturing accounts for about 45 percent, and trade/hotels/restaurants about 38 percent of informal firms.

\textsuperscript{13} CSA (2006), the 2005 Labor Force Survey Report
The fact that the agriculture and informal sectors have not been generating tax revenues for the government can serve as a tangible evidence to support the claims of formal businesses that they have been overburdened.

It is worth noting here that the Growth and Transformation Plan sets a target for tax revenue of 15.3 percent of GDP by 2014/15. If this is to be a realistic target then the tax base must be significantly widened over the coming five years. If the trend of the last few years continues and such a widening of the tax base does not take place, this would imply a tax burden on the non-agriculture sector in the region of 35 percent. There is no argument with Government efforts to increase total tax revenues; it is imperative, however, that this is done in a way which does not strangle the still infant private sector, thereby setting back the economic development of the country as a whole.

4.3 Revenue Impacts of the Reform

The tax reform has certainly increased government revenue since its introduction. The evidence above indicates that the increase has been achieved almost entirely at the expense of easy to tax formal and large businesses. It is clear that the tax base remains very narrow. Whether tax revenues would have increased by more or less without the tax reform is difficult to say, and beyond the scope of this study. It is quite possible, however, that the way in which the tax reforms have been implemented has led to their being less effective than might have been hoped by the government. The results of the survey shown later in this report certainly suggest that it is the implementation of the tax laws which causes greater concern to businesses than the laws themselves.

It could, in fact, be argued quite persuasively that the tax reform has resulted in the worst of all worlds; not only has government revenue fallen as a proportion of GDP but the largest businesses, those most likely to be competitive internationally, those with the greatest potential to export or to produce goods substituting for imports, have been hit the hardest, thereby reducing their competitiveness. The lack of revenue in turn impacts on government plans to invest in public goods such as transport infrastructure, resulting either in lower investment or, through borrowing, crowding out of private investment, both of which serve to reduce further the nation’s international competitiveness.

Probably the most significant change which has resulted from the tax reforms is the rise of VAT as a source of tax revenue. The share of VAT in total tax revenue reached about 41 percent in 2007/08 and this tax is almost certainly the reason for the increase in the proportion of revenue from indirect taxes. VAT operates on a much wider base than the sales tax that it replaced and, moreover, is far harder to evade, as its application through the value chain allows the tax authorities to cross-check sales invoices and sales receipts.
5 Survey of the Impact of Tax Reform on the Private Sector

This section is based on the findings of two surveys: the primary survey was undertaken amongst just under 300 businesses, tax professionals and tax administrators in Addis Ababa; the second was carried out in six cities of Ethiopia: Addis Ababa, Adama, Bahir Dar, Dire Dawa, Hawassa and Mekelle, and covered some 700 businesses in total.

Table 4. Primary Survey Sample Characteristics

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxpayers</td>
<td>291</td>
<td>97.3</td>
</tr>
<tr>
<td>Tax officials</td>
<td>4</td>
<td>1.3</td>
</tr>
<tr>
<td>Tax practitioners</td>
<td>4</td>
<td>1.3</td>
</tr>
<tr>
<td>Total</td>
<td>299</td>
<td>100.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>VAT Registration</th>
<th>Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT-Registered</td>
<td>198</td>
<td>66.2</td>
</tr>
<tr>
<td>Non-VAT-registered</td>
<td>95</td>
<td>31.8</td>
</tr>
<tr>
<td>Not applicable</td>
<td>6</td>
<td>2.0</td>
</tr>
<tr>
<td>Total</td>
<td>299</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Survey Data

Table 5. Secondary Survey Sample Characteristics

<table>
<thead>
<tr>
<th>City</th>
<th>Survey sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Addis Ababa</td>
<td>289</td>
</tr>
<tr>
<td>Adama</td>
<td>83</td>
</tr>
<tr>
<td>Bahr Dar</td>
<td>70</td>
</tr>
<tr>
<td>Dire Dawa</td>
<td>132</td>
</tr>
<tr>
<td>Hawassa</td>
<td>64</td>
</tr>
<tr>
<td>Mekelle</td>
<td>62</td>
</tr>
<tr>
<td>Total</td>
<td>700</td>
</tr>
</tbody>
</table>

Source: Survey Data

Both surveys employed a stratified random sampling method so that every sector of the economy is represented in the interview sample. The orientation of the businesses included in the main survey are shown in the pie chart below.
The survey respondents were asked questions about a number of different aspects of the tax system and tax reform, ranging from the perceived simplicity and transparency of the tax system to specific issues such as enforcement and compliance. The full questionnaire is attached as Annex A. The results are presented in the following sections.

5.1 General Principles of Taxation

5.1.1 Degree of Complexity of Tax Laws

Simplicity in tax laws:

- enables taxpayers to understand the rules and comply with them cost-effectively;
- reduces the number of errors, improves compliance, and increases respect for the system;
- promotes transparency and cost-effective collection.

Respondents were asked their opinions on the simplicity or complexity of the tax laws. The results are shown in Figure 3 below. Over 80 percent of the sample consider the laws to be either complex or very complex, with only a very small minority believing them to be simple. It is interesting to note that even the tax officials interviewed did not consider the tax laws to be simple.
5.1.2 Transparency of the Tax System

For effectiveness of tax law, transparency is a critical issue. Taxpayers should know that a tax exists and how and when it is imposed upon them and others. However, as Figure 4 shows, the majority of respondents (c.70 percent) considered the tax system to be lacking to some extent in transparency. This suggests that efforts by the tax authority to improve the transparency of the tax system would be beneficial. The success of the Egyptian tax administration is attributable to its high degree of transparency to tax payers.
A central issue which is seen to reduce the transparency (and fairness) of the tax system is that of the implementation directives which are issued by government organs. Unlike the proclamations and regulations, these directives are not readily available and accessible to taxpayers, hence making it difficult for taxpayers to know exactly their responsibilities. In addition, directives are not always consistent with the primary legislation that they are intended to implement. In such a case, it can be argued that they are unlawful and should be struck down by the courts.

Another element of transparency is the timely provision of information to taxpayers. This is also important for the effective collection of tax. However, the failure to inform taxpayers of changes or adjustments made to tax laws is another major problem. As Figure 5 shows, the majority of businesses maintain that they are not informed in advance of changes to tax laws or regulations. The problem is most severe in the finance, insurance, real estate and construction sectors. Public enterprises, in contrast, are fully informed of changes made to existing laws in good time. The tax authority sends information directly to government bodies and some large taxpayers. The majority, however, only discover the changes when they go to the authority to discharge their tax responsibilities. This is hardly consistent either with creating a conducive business environment for the private sector or with easing compliance of business with tax laws and must be improved. ERCA should realise that the majority of taxpayers wish to obey the law and fulfil their obligations; they cannot do so if they do not know what those obligations are. All taxpayers should therefore receive notice in good time regarding any changes made to laws so that they can act accordingly.

Figure 5. Whether businesses receive prior information on changes

Similarly, businesses were asked about information and education issues, in terms of the materials they receive from the tax authorities and what training or assistance they have been given. The responses are shown in Figure 6.
Figure 6. Taxpayer education and information

As shown in the chart, although a majority of businesses do receive information on tax issues, many do not. The responses to the other questions also suggest that there may be scope for ERCA to increase its efforts in training and awareness raising for taxpayers in order to reap benefits for all parties in the future through increasing the capacity of businesses to discharge their tax affairs correctly.

5.1.3 Equity of the Tax System

The equity of a tax system is normally considered in terms of horizontal equity – the equal treatment of equals – and vertical equity – the unequal treatment of unequals. Horizontal equity is generally seen as ensuring the fairness of a tax system while vertical equity aims to achieve distributive justice.

As shown in Figure 7, the vast majority of the respondents contend that there is no equity in the tax system since the burden of tax falls excessively on those large businesses that are clearly visible and within easy reach of the authorities. The impact of over-taxation of big and visible businesses is excessively lowering legally earned profits. The agricultural sector and small businesses, including the large informal sector, are taxed to a much lesser extent or not at all. The knowledge that achieving a certain size will bring a business onto the radar of ERCA acts in many cases as a significant deterrent to business growth and/or formalization.
5.1.4 **The Degree of Neutrality of the Tax Law**

In a neutral tax system, tax considerations should have the smallest possible effect on a taxpayer’s economic decisions about whether or how to carry out a particular transaction, neither encourage nor discourage taxpayers from engaging in certain activities, and be neutral when determining how to measure income, the appropriate tax rate, and taxpayers’ ability to pay.

In practice, tax systems are frequently designed not to be neutral in order to influence the behaviour of taxpayers, either through internalisation of externalities, e.g. taxing emissions of environmental pollutants, or to provide incentives for certain activities, e.g. investment promotion. Care should be taken when doing this in order to avoid unintended and potentially undesirable consequences but the tax system does provide a method by which government can provide incentives for the private sector to support its economic development goals.

A significant minority of those surveyed consider the tax system to be essentially neutral, though almost half thought the system to be not neutral, as Figure 8 shows.
5.2 Tax Enforcement

The way in which the tax laws of a country are enforced is an important element of the business environment. A number of questions were asked on this aspect of the Ethiopian tax system.

5.2.1 Technical Capacity of the Tax Administration

VAT in particular requires administrative capacity both within the tax authority and on the part of the private sector through accounting and reporting. It is clear that the capacity of much of the private sector is so low that it forms a major obstacle to effective implementation of the law. On the other hand, whilst there is quite a spread of opinions, the capacity of ERCA to administer the tax laws is considered by a small majority to be average or better. Given that tax authorities are not generally held in high regard in any jurisdictions around the world, this should be considered to be a fairly positive assessment of ERCA.

![Figure 9. The Degree of Technical Capacity of the Tax Administration](source: Survey Data)

5.2.2 Fairness of Enforcement Mechanisms

Whilst the technical capacity of the tax administration is reasonably well thought of, that is certainly not the case when it comes to the methods employed to enforce compliance with the tax laws. Tax law enforcement is often a contentious issue and this is definitely the case in Ethiopia. Respondents were asked their opinions of the fairness of the tax law enforcement mechanisms in operation. Two-thirds of the respondents consider the mechanisms to be totally unfair. Sanctions considered to be especially inequitable were the size of the financial penalties for such misdemeanours as late reporting of VAT, the persecution of business owners, and enforced closure of businesses (Figure 10).
Given that VAT implementation is still in its infancy and there is still a poor understanding of the system among many taxpayers and, to a lesser extent, the tax authority, penalties for non-compliance are considered unnecessarily harsh. A less confrontational approach, with severe penalties reserved only for severe infringements, would be likely to improve the longer term collection of revenue through a broadening of the tax base as informal businesses see more benefits and fewer disbenefits from formalization.

This point is reinforced by the responses to the question on VAT registration. An overwhelming majority of respondents believe that many businesses which should be registered for VAT, i.e. with annual turnover above Birr 500,000, have not done so. Their opinions of the main reasons for avoiding registration are shown in Figure 11 below.
A clear interpretation of these responses is that many businesses recognise their own lack of capacity to deal with tax issues adequately, especially VAT, which they perceive as being complex and costly to administer. They are also aware of the severe treatment meted out by the tax authorities in cases of incorrect returns, whether intentional or not, and therefore prefer to stay “out of sight” and take their chances on not being discovered. A more understanding approach by ERCA might persuade some of these businesses to enter the tax net and thereby improve revenue collection.

5.2.3 Severity of Financial Penalties

The financial penalties imposed on taxpayers in breach of tax laws, either knowingly or unknowingly, are often very severe. In some incidents, the financial penalty exceeds the total value of the assets of the business, leading to its closure. As Figure 12 shows, more than 80 percent of the respondents consider the financial penalties to be severe or very severe. The doubling of taxes as the penalty for failure to meet a deadline after just a month has no economic or moral justification. More usual practice is to charge interest on late payments and only to impose additional penalties in the case of persistent offenders. The greater proportion of VAT-registered businesses rating the penalties as severe or very severe may also be a reflection of the relative weight of sanctions for infractions of VAT rules when compared to penalties for other tax non-compliances.

Figure 12. Perceived Severity of Financial Penalties

![Figure 12. Perceived Severity of Financial Penalties]

Source: Survey Data

In summary, the tax enforcement regime is viewed by the business community as excessively punitive, both in the predisposition of the authorities to impose punishment for minor errors rather than helping taxpayers to correct such errors made in good faith, and in the harshness of the financial penalties imposed, which are viewed as being wholly disproportionate to the severity of the “offences” committed by
taxpayers. One of the results of this approach is to discourage businesses on the periphery of the tax system from entering it and to encourage informal businesses to maintain such status rather than risk having to deal with a tax administration which is perceived as being hostile to business. These effects are bad for business, bad for economic development and bad for revenue collection – a classic “lose-lose” situation.

5.3 Compliance Costs

All tax systems impose a burden on taxpayers over and above the value of the tax collected, through the time and cost required to ensure fulfilment by the taxpayer of his or her obligations. This compliance burden is the total time and money spent on filling out forms, keeping records, learning tax rules, and other tax-related tasks. Studies have shown that compliance costs are highly regressive: for a small business they are typically 3-5 percent of turnover, as compared to 0.1-0.2 percent of turnover for large businesses.

The survey asked people’s views on the costs of compliance with Ethiopia’s tax laws and, as shown in Figure 13, almost 90 percent believe the costs of compliance to be high or very high.

Figure 13. The Costs of Complying with Tax Laws

![Figure 13. The Costs of Complying with Tax Laws](image)

Source: Survey Data

One result which might initially appear counter-intuitive is that the non-VAT-registered businesses assess compliance costs as slightly more onerous than VAT-registered businesses, even though they do not have to deal with VAT issues. This response is, however, consistent with the regressive nature of compliance costs, in that those businesses not registered for VAT are smaller than those which are registered and hence the compliance burden may still be as high or higher for them.
There are a number of implications for businesses which spring from this. As Figure 14 shows, the most significant negative effects on businesses are considered to be reduced productivity and reduced competitiveness of businesses (though this latter finding may result from a poor understanding amongst businesses of compliance cost as opposed to their actual tax bill).

![Figure 14. Impacts of high tax compliance costs on business](source)

It is interesting to note, also, that almost one-third of the survey respondents believe that high compliance costs act as a disincentive to formalization of businesses, a view consistent with the academic findings on the regressive nature of these costs. There are a number of ways in which tax administrations around the world attempt to ameliorate the burden for small businesses. It is ironic that in Ethiopia, a country whose economy is dominated by micro and small enterprises, no such effort appears to have been made.

### 5.4 Tax Administration

Although private sector businesses have some concerns about the tax system and would all like to pay less tax, business people reserve their greatest complaints for the way in which the tax laws are administered rather than the laws themselves.

#### 5.4.1 Main areas of dissatisfaction with tax administration

Figure 15 shows the main areas of dissatisfaction with the way in which the tax system is administered. The shifting of the burden of collection and the cost of collection are clearly related and both equally clearly are concerned primarily with VAT collection. If the Government wishes to improve the relationship between the tax authorities and the private business sector, making the collection and payment of VAT less onerous would be a good place to start. There are a number of changes which could be made which would not have any significant negative implications...
for revenue and which might even result in an increase, whilst at the same time making life easier for businesses. Some proposals are offered in Section 6 of this report.

**Figure 15. Major complaints concerning tax administration**

<table>
<thead>
<tr>
<th>Perception</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shifting of tax collection burden to taxpayers</td>
<td>70%</td>
</tr>
<tr>
<td>Tax collection expense to taxpayers</td>
<td>60%</td>
</tr>
<tr>
<td>Compulsory hiring of accountants</td>
<td>30%</td>
</tr>
<tr>
<td>Business unfriendly enforcement</td>
<td>20%</td>
</tr>
</tbody>
</table>

*Source: Survey Data*

### 5.4.2 Positive and Negative Impacts of Reform

Tax reform has impacted the private sector in many ways. Unsurprisingly, businesses are focused mainly on the negative impacts but some positive impacts have also been noted. The main points are shown in Figure 16, with negative impacts shown in red and positive impacts in green.

The negative perceptions are concerned mainly with the time and cost burden of paying taxes and reinforce the points made in earlier questions; this is no surprise – very few people enjoy paying taxes. However, it is very striking that the reform of the tax administration, perhaps as a result of the business process re-engineering, has been recognised by businesses as significantly improving the bureaucracy associated with the tax system. A few of those surveyed also remarked on the more convenient tax payment options available, such as payment through intermediary organizations like banks, as a result of the reforms. Further reforms along similar lines would be greatly appreciated by businesses.
5.4.3 Profit Tax Assessments by ERCA

The basis of tax payments is self-assessment by the taxpayer (usually based on internally prepared accounts or those prepared by external accountants) but ERCA does not always accept the self-assessed report. In such cases, the tax authority makes its own assessment, apparently quite subjectively. The revised assessment is invariably more than that of the original self-assessment and, as with other aspects of dealing with the tax authority, erodes trust in the fairness, transparency and integrity of both the authority itself and the entire tax system. It is also unacceptably biased against taxpayers.

According to the results of the survey, this has a number of direct impacts on taxpaying businesses and their behaviour, shown in Figure 17.

Figure 17. Impacts of Subjective Tax Assessments by ERCA

Source: Survey Data
It is interesting that more than half of those surveyed take the view that this type of incident actually discourages businesses from keeping books of accounts, as it seems to an outside observer that such records would be the ideal means for disputing the revised assessment. It is understandable, however, that a business which has been reassessed in spite of having fully audited accounts might take such view.

As observed by more than half of the survey sample, it is self-evident that such arbitrariness in making tax assessments provides opportunities for corruption and malpractice. The Federal Ethics and Anti-Corruption Commission has also joined the condemnation of this practice.

5.4.4 Tax Appeals

Businesses are able to appeal against rulings by the tax authority, though such an appeal requires a cash deposit to be made and can be quite a lengthy process. Figure 18 shows the opinions of surveyed businesses about the relative time taken for a decision on an appeal. It is interesting to note that overall, almost 60 percent of those asked consider the process to be excessively long, whereas the public enterprises universally felt the process to be a short one. It is difficult to see this as anything other than a systematic bias against the private sector.

The general view amongst most people surveyed is that there is little point in appealing as the costs of doing so far outweigh any potential benefit that might accrue. This indicates strongly that the system is in need of a fundamental overhaul to restore faith amongst taxpayers in its fairness.

A related issue often raised by taxpayers is the difficulty of recouping any accidental overpayments of tax. Almost all respondents who have faced such a problem said...
that they have not managed to recoup their money because there appears to be no mechanism in place for this situation, in spite of the fact that this is provided for in the law. The tax authority usually carries forward the extra amount for the next tax year. However, this has cash flow and cost implications for the businesses affected and, if the situation were reversed, it seems unlikely that the tax authority would be prepared to wait for an underpayment to be made up the following year. The tax authority should treat taxpayers as it expects to be treated by them and hence should have a mechanism in place for timely refunds of overpaid tax, regardless of the reasons for the original overpayment.

5.5 Value-Added Tax

One of the central elements of the tax reform undertaken by the Government of Ethiopia was the introduction of Value-Added Tax, or VAT. This tax has also given rise to some of the greatest objections from the business community.

5.5.1 Business Complaints about VAT

Respondents were asked to indicate their main complaints about the VAT system. Most of the businesses had more than one area of concern, and the results are shown in Figure 19. More than three-quarters of businesses complained about the high rate of VAT. It should be noted in this regard, however, that the Ethiopian rate of 15 percent is not excessive by international standards and is, in fact, fairly typical of VAT rates around the world. A survey of almost 100 countries operating a VAT system indicated that the mean VAT rate is just above 16 percent; if the countries of the European Union (where VAT rates are generally somewhat higher than elsewhere) are excluded, the mean rate drops to 14.5 percent, still indicating that the Ethiopian system is by no means out of step with international practice.

A further point on the VAT rate is in order; revenue derived from VAT now accounts for over 40 percent of total tax revenue for the Government of Ethiopia. If the rate were to be reduced, this would cause an immediate and massive loss of revenue to the government, which would have to be offset by other tax means. Although revenue can be increased by broadening the tax base, this approach is much more long term, hence there would seem to be little practical alternative to continuing with VAT at its current level.

The second most common complaint was the incomplete registration of businesses for VAT; opinions on the reasons for this have been discussed in Section 5.2.2 (see Figure 11). This, coupled with the perceived inadequate harmonization of VAT and TOT, could well be the root of some of the dissatisfaction and concern over the VAT rate itself, the result being distortion of the market and resulting unequal competition. Indeed, honest businesses that are registered for VAT feel let down by ERCA in two ways: firstly, because of the level of harassment to which they are subjected over relatively trivial issues; and secondly, over the apparent failure of the authorities to exercise a similar level of zeal in pursuing those businesses which are evading VAT entirely and thereby gaining a competitive advantage.
There are also some significant concerns about the record keeping and reporting requirements that VAT imposes on businesses, with around 40 percent of respondents citing these issues. A significant easing of the compliance burden could be achieved through a reduction in the reporting frequency to quarterly rather than monthly. Full self-assessment, with only selected audit by ERCA would also reduce the workload for both businesses and ERCA itself, allowing more resources to be allocated to taxpayer registration, support and compliance rather than simple administration. Increased use of electronic payment schemes in the future would also help both taxpayers and tax collectors in this regard, as well as a less prescriptive approach to the keeping of records by businesses.

5.5.2 Impact of VAT on Businesses

The introduction of VAT has been perceived by registered and formal businesses as having a number of negative impacts. The most significant of these are unfair competition, cited by 87 percent of respondents, and additional costs, mentioned by just over half of those surveyed, such as purchases of hardware and software for record keeping, training and hiring external accountants and other professionals. (Figure 20).
A number of suggestions were made by businesses surveyed in order to mitigate these effects. Among the more practical were wider VAT registration and better harmonization of TOT with VAT. Better control of contraband goods and clamping down on abuse of tax-free privileges were also proposed.

Although businesses can (at least in theory) pass on the full amount of VAT to consumers, they cannot escape other costs, some of which are one-time costs and others of which are recurring. These include the purchase of sales machines, printing of VAT invoices, the need for frequent reporting to the tax authority in person, etc. All these costs have undesirable implications for businesses, as discussed in Section 5.3 on compliance costs.

Although VAT is a tax on consumption, due to the availability of VAT non-registered businesses, VAT registered businesses are not always able to pass the whole amount of VAT onto consumers. The alternative is to reduce profit margins. According to the survey, 59 percent of respondents asserted that they do not pass VAT onto consumers in full while the balance said that they do without affecting their profit margins (Figure 21)
As to why businesses were unable to pass the full VAT amount onto consumers, Figure 22 provides very clear answers. The most significant factor by some distance is the presence of non-VAT-registered firms in the same market as the VAT-registered firms, cited by almost all those who responded to the question. The presence of firms that are evading taxes (which amounts to much the same thing in practice as non-registered firms) was also considered significant by over a quarter of respondents. Lack of harmonization of TOT and VAT was also mentioned, but only by a relatively small number of businesses.

The inability of businesses to pass the entire amount of VAT on to consumers has impacts on such businesses. The major impacts include the weakening of the VAT-registered businesses, a shift of businesses from the formal to informal sector, and flourishing of unfair competition, amongst others. None of these effects can be con-
sidered helpful to the growth of a robust private sector to drive economic development and global competitiveness in Ethiopia.

Figure 23. Impacts of Inability to pass on VAT in full to Consumers

<table>
<thead>
<tr>
<th>Impact</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weakening of VAT-registered businesses</td>
<td>80%</td>
</tr>
<tr>
<td>Shifting of businesses to informal sector</td>
<td>60%</td>
</tr>
<tr>
<td>Flourishing of unfair competition</td>
<td>40%</td>
</tr>
<tr>
<td>Reducing employment</td>
<td>20%</td>
</tr>
<tr>
<td>Closure of VAT-registered businesses</td>
<td>0%</td>
</tr>
<tr>
<td>Preferring to remain informal</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: Survey Data

5.5.3 VAT Registration Threshold

Following on from issues of the perceived competitive disadvantage of being registered for VAT, businesses were asked their views on the threshold for compulsory registration (notwithstanding the widely held view that many businesses are avoiding registration at the current level). The responses are shown in Figure 24. Although there is a broad spectrum of views, it can be said that there is a strong body of opinion that the existing threshold of Birr 500,000 should be reduced in order to bring more businesses into the VAT net.

Figure 24. Opinions on VAT registration threshold

Source: Survey Data
5.5.4 VAT Refunds

The law provides for refunds of VAT for businesses which pay more input VAT than they charge on their outputs. This is particularly relevant for exporters, where the zero rating of exported products is one of the claimed advantages of a VAT system in promoting exports. As discussed in section 2.5, however, tax authorities are often somewhat tardy in making refunds and the survey results indicate that Ethiopia is no exception to this rule.

Overall, only 36 percent of respondents said that VAT refunds were made by the tax authority on a timely basis. Only public enterprises reliably received refunds due within the time limit stipulated by the law, as shown in Figure 25. This is another example of the actions of public agencies being at variance with government rhetoric concerning the importance of the private sector. The performance of ERCA was considered especially poor in the case of finance, insurance and real estate companies.

Figure 25. Timely reimbursement of VAT claims, by business sector

<table>
<thead>
<tr>
<th>Business Sector</th>
<th>0%</th>
<th>20%</th>
<th>40%</th>
<th>60%</th>
<th>80%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
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<tr>
<td>Mining</td>
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<tr>
<td>Construction</td>
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<td>Manufacturing</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Transport, Communications, etc.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale, Retail sale</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finance, Insurance, Real estate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hotel, Hospital</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public enterprises</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All sectors</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

Source: Survey Data

The delays in VAT refund have a number of implications for businesses at all scales. Almost all respondents (94 percent) alluded to the cash flow costs of slow or non-existent refunds and more than half were concerned about the associated interest costs of borrowing to cover working capital requirements whilst awaiting refunds.
5.5.5 Other Comments on VAT

**VAT Rate**

Just over 20 percent of the survey participants said that the rate of tax authority should reduce the rate of VAT from 15 percent. This indicates a lack of understanding in several respects: firstly, the Government sets the tax rates, not the tax authority. Secondly, the Ethiopian VAT rate is not excessively high, as these respondents seem to believe; a rate of 15 percent is very close to the international average for VAT. Thirdly, it would be completely impractical to reduce the rate; every 1 percent reduction in the rate of VAT would reduce government tax revenues by 4 percent, hence requiring some additional revenue measure to be introduced to compensate.

**VAT on Food**

Almost one third of those surveyed requested that VAT be removed from food items. A very restricted range of food products (milk, bread, cereals, pulses and palm oils) is already exempt from VAT but there is a case to be made that a wider range of food items should be subject to a zero VAT rate (which is not quite the same as exempting it from VAT) in order to address objections about the regressive nature of VAT.

**Other VAT Issues**

**Tax Dialogue**

A few amongst the survey sample recommended arranging regular discussion meetings between taxpayers and the tax authority; This is an excellent idea which should be part of the public-private dialogue.
Tax Investigation

A further request was that the tax authority should revisit the methods they use in tax intelligence and intelligence activities, such as buying goods without receiving receipts and using this as a basis for accusations of systematic VAT fraud. Such findings should be used as a basis for warnings and taxpayer education rather than immediate criminal proceedings.

5.6 Other Impacts of Tax Reform on Private Sector Development

5.6.1 Impacts of Tax Reform on Private Investment

The tax law offers tax incentives to investors so as to attract foreign and domestic investment to Ethiopia, especially in certain priority sectors. Survey respondents were fairly evenly split on the benefits of this. According to 47 percent of the respondents, the new tax law in force is encouraging for private investment, whilst around 45 percent feel that it is discouraging, the balance believing that the law is essentially neutral in this regard (See Figure 27).

Figure 27. Tax law impact on investment

According to those respondents who believe that the law encourages private investment, the reasons given are:

- Exemption of investment goods from customs tariffs and other related taxes;
- The availability of tax holidays.

Those who saw the tax law as neutral cited the far greater importance in their view of issues such as access to land and finance.
Those who claimed that the law is discouraging gave as their reasons the abuse of tax free privileges (notably the diversion of goods intended for investment into other markets), and the fact that the available incentives disfavour existing businesses/investors.

5.6.2 Impacts on Export Development

One of the benefits claimed for a VAT system is that it benefits exports, through the exemption from VAT of exported goods and services. If a VAT-registered business pays more input VAT than it charges (which will often be the case for exporters), a refund is provided. Slow processing of this VAT refund is frequently a point of friction between the private sector and the tax authority.

As shown in Figure 28, only about 40 percent of respondents believed the existing tax law to be beneficial for export development, with almost half saying that they thought it discouraged exports. Since the law offers tax rebates, VAT exemption on export items and zero tariff rates on export, it is clearly intended to encourage exports. Some respondents claimed that the VAT refund has no impact on export since the exported products are sold in international markets. This view is clearly at variance with the facts in that VAT exemption is obviously better than a sales tax being levied on exports. This is, perhaps, further evidence that many businesses fail to understand how a VAT system works and points to the need for better education and capacity building amongst the private sector on tax matters.

Figure 28. The Impacts of the New Tax Law on Export Development

Those who felt that the tax law was discouraging for exports explained that it was not the law itself that discouraged exports but its implementation; bureaucratic
hurdles such as long delays in collecting VAT refunds and the onerous administrative procedures required in order to benefit from the incentives for exports more than offset the benefits of the law’s provisions. This finding is consistent with those of the academic studies discussed in section 2.5.

5.6.3 Impacts on the Development of Domestic Industry

The tax system is widely used as a policy instrument by governments, especially in industrializing countries, to support the development of a domestic industrial base and to protect their infant industries through the levying of tariffs on imports, and providing tax (and other) incentives for import substitution. Almost three-quarters of the survey respondents believed that the current tax law does indeed encourage the development of domestic industry since it enjoys high tariff protection from cheap imports, gets better treatment from government in terms of access to infrastructure, land, etc., and receives exemption from taxes on machinery and raw materials (Figure 29).

A small group maintained that the tax law was neither encouraging nor discouraging, as VAT is applied equally to both imported and domestic industrial products. Just over a quarter of the respondents asserted that the tax law has no encouraging effect because the level of tariff protection enjoyed by domestic industries is insufficient to enable them to compete with imported products in the local market. This observation, though possibly an accurate assessment of the situation, could be seen as something of an indictment of the capabilities and capacities of Ethiopian manufacturing companies.

Figure 29. The Impacts of the Tax Law on Domestic Industrial Development

Source: Survey Data
5.7 Tax and Accounting Issues

5.7.1 Keeping Book of Accounts

When assessing the private sector’s capacity to comply with the tax law, one critical question is to what extent an average firm keeps accounts and tracks financial records. In this connection, respondents were asked whether they keep accounts and who is involved in the task. Over three-quarters of businesses participating in the survey said that they kept accounts (see Figure 30), with fewer than 2 percent admitting to having no formal books of accounts. Almost 23 percent did not provide an answer to this question, from which it is not unreasonable to assume that most if not all of these businesses also lack proper books of accounts.

Figure 30. Does Your Business Keep Books of Accounts?

Source: Survey Data

For those businesses with formal accounts, more than 98 percent use their own staff for this task, with only a handful employing external accountants or auditors for this. This is consistent with the views of tax professionals, who observe that very few businesses ask for advice or assistance on their tax affairs until they encounter problems with the tax authorities.

5.7.2 Accounting and Auditing Firms

Respondents were asked whether private accounting and auditing firms have been growing in number and capacity over time. Just over three-quarters agreed with this statement.
A modern tax system requires adequate capacity on the part of the private sector through accounting and reporting, as well as capacity in the tax authority. This, in turn, requires well functioning, capable and credible accounting and audit firms, and a desire amongst businesses to make use of them. At present, it would seem that there are sufficient accounting firms for the level of demand but that this is only because businesses do not make as much use of such services as they should. If the capacity of the private sector is to improve, then action will be needed at both the level of individual firms and in strengthening the capacity of financial support services.

As regards possible measures to improve the situation, a number of suggestions were made, the most popular of which are shown in Figure 31.

**Figure 31. Proposed Measures to Increase Private Sector Capacity**

![Chart showing proposed measures to increase private sector capacity]

*Source: Survey Data*

As can be seen, a good majority of those surveyed thought that standardization of the system would be a step in the right direction. The working group on the adoption of international accounting and auditing standards will be heartened to hear this. The two other suggestions with support from around 30 percent of the survey sample both revolve around improving the standard of record-keeping by businesses. This general theme of increasing private sector capacity is one which has appeared throughout the survey; it is clear that, whatever faults there may be in the tax laws or the tax administration, there is considerable work to be done within the private sector in order to improve the functioning of the Ethiopian tax system. The Government has a leading role to play in this, especially in terms of providing education and information, but the private sector also has to play its part.
5.8 Perspectives of Tax Officials and Practitioners

The survey results above present essentially the views of private sector businesses as, although tax officials and tax practitioners were included in the interview sample they constitute only a small proportion of it and their views will be largely lost amongst the business consensus.

5.8.1 Tax Officials

A key element of the tax reform programme has been the restoration of fiscal discipline and an increase in domestic resource mobilization. To eliminate poverty, the government is in need of local resources, of which tax revenue is the major source. Hence, there is a general tax claim of up to 25 percent of GDP. Based on this premise, the following main observations were made by tax officers:

- There appears to be a substantial gap between the tax that potentially could be collected and the tax that is actually collected.
- There is widespread non-compliance by taxpayers.
- There appears to be a failure to register by potential taxpayers.
- An attitude exists of not declaring full income to the tax authorities.

Largely on the basis of these assumptions, the tax authorities take stringent measures, including blocking of bank accounts, arresting and penalizing defaulters, in order to show zero tolerance to any form of tax evasion and fraud.

The tax authorities are now far more effective than were 5-10 years ago. In spite of this, the tax authorities need to market themselves better and provide more effective taxpayer support to the general public for better compliance and improved enforcement.

5.8.2 Tax Practitioners

Professional tax practitioners stated that most taxpayers are not in the habit of consulting on or outsourcing their tax issues. Taxpayers turn to tax practitioners only when they encounter a problem with the tax authorities. In normal circumstances they are not prepared to pay for tax practitioners or advisors. Businesses generally do not value the cost of professional fees as a integral part of their compliance effort.

On the other hand, some small businesses had been turned away by tax professionals because they “could not afford the fees”. The practitioners also referred to the problems faced by taxpayers, which include poor record keeping, illiteracy, lack of awareness and knowledge about the role of tax in nation-building and selfishness. The tax practitioners accept that taxpayers also face legal and administrative problems which require the attention of tax authorities.
6 Conclusions and Recommendations

6.1 Summary of Key Findings from Business Survey

A number of reforms have been made to the tax system of Ethiopia. There are, however, still significant discrepancies between the laws and directives and several ambiguities in the proclamations, regulations and directives. Moreover, there is often a considerable time lag between the issuance of tax proclamations and regulations, and the associated implementation directives, which increases risk and uncertainty for businesses.

As indicated in the preceding sections, respondents from the business community believe that the tax reform has had a detrimental effect on private sector development in a number of ways. Their main concerns are:

- The tax laws are too complex;
- The tax system is neither fair nor equitable and it lacks transparency;
- The tax system does not minimize noncompliance, it increases compliance costs, and in cases of dispute the appeal process is excessively long;
- The available tax privileges are not favourable for either SMEs or large enterprises;
- The tax reform impedes production, favouring certain sectors at the expense of others;
- The tax base is too narrow and the burden of taxation falls excessively on larger, formal businesses;
- Tax administration is inefficient, arbitrary and relies heavily on coercion, penalties and imprisonment; penalties for minor transgressions are disproportionately high;
- The tax administration is not effective in collection, has not developed a strategy for collecting taxes and has shifted the costs of collection onto the private sector;
- Service and support to taxpayers service is grossly inadequate, and public-private dialogue has been insufficient;
- The VAT administration and compliance system is not well designed and VAT has created economic distortions amongst VAT registered and non-registered taxpayers.
6.2 The Impact of Tax Reform on the Private Sector

Based on the survey findings and on the desk research undertaken for this study, the overall impacts of the tax reform are outlined here, with recommendations for actions which could improve the situation for both private sector businesses and the Government of Ethiopia.

6.2.1 Tax Structure and Tax Laws

**Income/Direct Taxes**

- The income tax is basically sound compared to the pre-reform period but it still lacks some important provisions for broadening the tax base. However, certain deductions, tax incentives and privileges provide unnecessary advantages for large businesses over SMEs without necessarily stimulating economic growth and may result in unnecessary losses of revenue to the government.

- The income tax code categorizes taxpayers by legal entity and capital. Those with separate legal entities are federal taxpayers, while Category A, B and C taxpayers are associated with national regional states. This has created a lack of harmonization between profit tax and presumptive tax, and between VAT and turnover tax, which in turn has created discrepancies between businesses. Similarly, self-assessment, audit, investigation and intelligence activities are not applied consistently and there is a case for restructuring the tax system in order to provide a more level tax “playing field”.

- The law requires taxpayers in Category A to keep books of accounts and to have them audited externally, and then to assess their own taxes based on this. The tax authority frequently ignores this assessment, however, and carries out its own assessment. The resulting tax assessments are not consistent and result in taxpayers of equal incomes paying different amounts of tax.

**Consumption/Indirect Taxes**

- VAT, as a relatively new phenomenon, is considered to be one of the major sources of complexity in the Ethiopian tax system. VAT has a considerable advantage over sales tax in terms of revenue mobilization and economic efficiency, but VAT implementation has imposed a large compliance burden on taxpayers, who must file regular self-assessment forms and keep accurate records of the tax paid on purchases as well as that collected on sales. This burden is especially onerous given the low administrative capacity of many businesses in Ethiopia.

- Currently, the annual turnover threshold for VAT registration is Birr 500,000. Although where the tax administration has low capacity it is considered good practice to set the threshold at a high level, this allows businesses of a significant size to avoid VAT registration and can create inequalities and a strong sense of unfairness amongst VAT-registered businesses at what they see as unequal competition resulting from the tax system. This can lead to attempts by businesses to avoid registration or evade tax because they see it as a threat to their continued existence and the risk of detection is perceived as worth taking. In other words,
perceived inequality and unfairness can drive otherwise law abiding business people into breaking the tax laws. It is important that ERCA tackles the causes of this behaviour rather than simply focusing on enforcement as in the longer term this will be better for everyone.

- Lack of well trained tax practitioners, accountants and lawyers, coupled with poor understanding amongst businesses, has created problems for businesses in administering VAT. This brings with it the constant threat of severe penalties for non-compliance which results from errors rather than deliberate attempts to evade tax.

- It is very clear that whatever consultation may have been carried out in advance of the introduction of VAT and whatever information may have been disseminated to business, these efforts were not sufficient and as a result there are still widespread misconceptions, misunderstandings and confusion about the operation of VAT. This situation, coupled with the other points made above, has created an extremely negative perception of VAT amongst businesses and it will take a major effort now from ERCA to instil greater faith in the tax system amongst taxpayers.

**Recommendations on Tax Structure and Tax Laws**

In order to address these issues of tax structure and tax laws, a number of actions, both general and specific, are recommended.

- **Simplify the tax laws and equalise the tax burden faced by every business.** Reduce the scope for interpretation of the laws to increase certainty and reduce the scope for negotiation or corruption. By the same token, ensure that implementation directives are fully consistent with the laws themselves, and that these directives are well publicised and freely available to taxpayers.

- **Broaden the tax base** through a combination of new revenue measures and improved tax administration (strong tax administration, limiting special tax incentives, and closing loopholes for tax avoidance) to decrease the tax burden on private sector business whilst still generating more revenue.

- **Find ways to levy taxes appropriately on the agriculture and the large informal sectors** so as to ameliorate the tax burden on larger, more visible businesses and reduce the sense of unfairness and inequality that the system currently engenders.

- **Business/Corporate Profit Tax** should be improved by reducing tax exemptions and deductions. Tax credits, investment allowances, accelerated depreciation, and unified tax rates among different forms of business ownership are of great help to push investment and create a level playing field.

- **Consider lowering the VAT registration threshold** to bring more businesses into the VAT net. This can both reduce market distortion and increase revenue collection. This may require additional resources and greater capacity at ERCA.
6.2.2 Equity in Taxation

- The rate of business profit tax for those who maintain books of accounts is determined by law. Those who fall under presumptive taxation are subject to the assessment of the business by a committee. There are no well-defined rules for such assessments, which can lead to similar businesses being taxed widely different amounts on an arbitrary basis. Better record keeping by businesses and a better defined methodology for presumptive tax assessment would both help to ameliorate this situation.

- The extent of exemptions for individuals, employees and businesses needs to be revisited from both an economic utility and social welfare (transfer payment) point of view. On the one hand, exceptions and exclusions for businesses have to be critically examined in relation to tax rates, investment and impacts on SMEs; and on the other hand tax privileges have to be implemented cautiously to avoid stimulating investment (either domestic or foreign) which has short term benefits but which may not contribute to longer term economic development.

- Tax incentives to stimulate investment can sometimes harm established producers and also impair revenue mobilization. The costs of investment incentives in terms of revenue foregone by the government can often be significant, and experience in other countries has shown that such incentives can also result in “subsidy chasing” by businesses at the expense of more beneficial investments. Tax policy should be designed and analysed to stimulate private sector development and avoid such deleterious effects.

- Generating revenue without harming the private sector and destroying the incentive for businesses to grow and develop is the concern of a good tax system and the measure of effective tax reform. Squeezing the more visible elements of the private sector too much runs the risk of killing the goose that laid the golden egg. There are signs from the survey results that some elements of the private sector perceive the tax system in this way and the government needs to be careful that economic development is not held back as a result.

**Recommendations on Equity of Taxation**

- **Tax exemptions/privileges should be replaced by tax credits** and a system of appropriate depreciation and investment allowances. Moderate tax rates applied to a broad tax base are also to be preferred to heavy taxation of a narrow base. Experiences of transition economies where flat tax systems have been adopted would tend to support this approach.

- **Corporate Income Tax versus Presumptive Tax.** Whilst presumptive tax should still be used as a backup system, a move towards wider and better record keeping amongst businesses should be encouraged. For larger enterprises, the early introduction of accounting and auditing practices to international standards would have benefits beyond just the tax system. For smaller businesses, the presumptive tax assessment needs to be more consistent and could also be adjusted so as to provide an incentive to those businesses to keep better records and hence move to a more formal tax assessment basis.
The application and extent of tax incentives should be reviewed, and any proposal for new incentive schemes should have their likely impact comprehensively assessed prior to their introduction; the impact assessment should include full consultation with representatives of the private sector. This will help to avoid any unintended negative consequences. Particular attention needs to be paid that investment incentives support pro-poor development and do not unduly subsidise capital against labour, or cause unnecessary harm to existing businesses.

6.2.3 Tax Compliance Costs

- Accounting records, VAT accounts, sales and purchase invoices, and import and export documents are maintained by taxpayers. Although all businesses should be expected to maintain such documents, it is important that records required for tax purposes should, to the greatest extent possible, correspond with other records that the business requires rather than being in addition to them.

- One of the greatest compliance costs comes from the high frequency of tax payments. In the case of items such as payroll tax, which should be essentially constant, this should not be onerous but for payments such as VAT, which require some processing, monthly declarations and returns can absorb an excessive amount of taxpayers’ time. There are a number of ways to improve this situation.

- Small and medium enterprises may be forced to outsource accounting and legal issues in order to meet deadlines and produce proper financial statements. This can put them under some financial strain.

Recommendations on Compliance Cost

- **Filing of tax returns**: for business taxes such as profit tax and VAT, the compliance cost would be significantly reduced, with no major impact on government revenues, by moving to quarterly returns rather than monthly. Monthly returns should apply only to taxpayers who have been found to contravene the regulations (and are therefore “on probation”) and, possibly, to very large taxpayers; in this latter case a system of monthly payments on account could be adopted with a full return and accurate tax calculation only every quarter (or even, as is done in some jurisdictions, annually).

- **A less prescriptive approach to the nature of the documentation** maintained by a business to record its tax affairs could offer a considerable reduction in the compliance burden, especially for smaller businesses. As long as the essential elements of the business are captured, the precise form of the records should not be important.

6.2.4 VAT Administration & Compliance

- The tax appeal system is very long and time consuming. It requires a business to deposit 50 percent of the tax claimed. This leaves the business in a difficult position, and may infringe the rights of the taxpayer.

- VAT procedures are extremely prescriptive and impose an especially severe cost on some businesses; penalties for minor infractions are disproportionately high,
which imposes an additional psychological burden on taxpayers, which does not necessarily enhance the level of compliance as it is intended to do.

- Differences between the rates and administration of the Federal VAT and the State Turn Over Tax result in similar businesses suffering significantly different tax treatments. This, in turn, distorts the market and may put some businesses at a competitive disadvantage. TOT is not well administered, which exacerbates this problem.

- Invoices: The tax authorities have standardized the invoices for VAT and introduced one type of official invoice for simplicity and convenience. A consequence of this, however, is that the tax authority does not accept other forms of invoice, thus complicating rather than simplifying the process for businesses.

- Reconciliation: Reconciliation between sales and VAT declared has become a major headache for taxpayers. During the process there are instances where sales reconciliation between declaration and financial statements becomes especially difficult. This includes VAT payments at Customs points due to valuation and CIF and rate of exchange for foreign currencies.

- Consignment: The consignor and the consignee are asked to pay VAT on the same item or goods. This requires the coordination of VAT administration and collection between the Federal and Regional State tax authorities.

**Recommendations on VAT**

- **Filing of Returns**: There are a number of ways in which VAT filing could be streamlined. These include:
  - Less frequent returns, e.g. quarterly (which is standard in some jurisdictions) and options for annual returns for some smaller businesses.
  - VAT payments on a cash rather than invoice basis for SMEs.
  - Simplifying the filing and payment procedure through, for example, removing the need to present all documents at every filing; it should be sufficient just to have these available for audit if required.

Annex A has examples of various VAT simplification schemes.

- **Harmonization**: the Federal VAT and the State Turn Over Tax need to be congruent to balance the tax burden between VAT registered & unregistered businesses.

- **Payment and Refund**: More rapid refunds, e.g. 45 days, should be made for overpaid taxes.

- **Simplify Appeal Procedure**: The cash deposit to appeal need to be revisited and such prerequisites has to be rationalized to a certain extent that would keep in balance the benefits of the Government and the private sector.

- **VAT Refunds**: VAT refunds are legally mandated to be made within a period of 90 days. However, VAT refunds are mostly carried over from one tax year to the other. This practice is unlawful and should cease immediately.
6.2.5 Problems with Tax Administration

**Administrative Cost**

- Assessment is currently practised as self-assessment, reassessment, rectification and revision of tax returns. However, the self-assessment procedure is accompanied with prerequisites. For instance, a business has to attach sales and/or purchase invoices at the time of declaring VAT. The documents are also required for verification at the time of audit, thus the same documents are examined twice. Why? This is an unnecessary cost to both tax administration and taxpayer.

- Audit, Investigation and Intelligence need to be better integrated and targeted. The new proclamation limits audit to be processed within a 5-year period. The implementation of the time limits keeps the taxpayers from high tax compliance cost. Real audit should be carried out, with the intention of identifying deliberate evasion rather than simple errors, sometimes beyond the control of business owners/managers.

- Proclamation No. 286/2002 Article 76/1b mandates refunds to be effected within 90 days, and entitles taxpayers to the payment of 25 percent interest over and above commercial interest rates. All refunds of tax need to be expedited on time and in accordance with the law.

**Taxing Visible & Big Businesses Heavily**

- The tax level (ratio of revenue to GDP) in 2007/08 in Ethiopia stood at 10.3 percent. The tax level for the agriculture sector was just over 0.1 percent, with that for non-agriculture standing at over 20 percent. Business is bearing considerably more than its fair share of the tax burden with agriculture remaining essentially untaxed.

**Administrative Discretion**

- The degree of administrative discretion available to tax officials in determining assessments and penalties is an open invitation to malpractice.

- Many taxpayers lack skills to provide accurate information on total sales, especially related to VAT. This is an area in which business needs to help itself; if businesses cannot or will not keep adequate records they can hardly complain at their treatment by the tax authorities.

**Enforcement Mechanism and Penalties**

- The enforcement mechanism includes taxpayers’ service, official assessment, desk and field audit, intelligence and investigation. Lack of integration between these important tax functions results in an excessive burden on the taxpayer as well as adding to the costs to the tax administration.

- The penalty provisions in both direct and indirect tax laws are disproportionate to the severity of the offences. There is no recognition of the possibility of simple errors rather than deliberate attempts at evasion. This is typical of the imbalance between the tax administration and taxpayers – ERCA is not fined for
errors in tax assessments whereas taxpayers are. Such an unbalanced system is highly oppressive and a strong disincentive to business; it also breeds cynicism about the tax authority and the government itself.

- It seems excessively severe to hold business owners and managers in jail on suspicion of tax evasion prior to conviction. Such people are not a danger to the general public and, except where the sums of money involved are very large or there is a serious risk of the suspect absconding, less extreme measures would seem sufficient. Actions of this nature by the tax authorities can act as a strong disincentive to those businesses considering formalization and hence have a negative impact on overall revenue collection. Severe penalties should be reserved for those proven to have offended, not merely suspected of it.

**Taxpayer Service**

- Tax laws are published in the Federal Negarit Gazetta. The tax authority has also developed a web site to provide information related to tax matters and the investment code. Tax officials arrange meetings with taxpayers to provide clarifications on different tax issues. However, the availability of tax information to the public remains unsatisfactory. As a result it is not easy for the average taxpayer to understand and comply with the tax laws. Tax authorities also participate in other discussions with private sector representatives, though this is generally to convey information rather than to engage in dialogue on issues of interest to businesses. It is imperative that there is a higher level of engagement between public and private sectors on tax issues for the mutual benefit of both parties.

**Recommendations on Tax Administration**

- **ERCA must be adequately equipped with appropriate information technology (IT),** with trained staff to operate it. Though there have been substantial improvements in the organizational structure and procedural laws, there are still gaps between the tax laws and implementation; these gaps must be closed.

- **The imbalance between ERCA and taxpayers needs to be rectified.** The present system whereby taxpayers are subject to stiff penalties for even minor errors while ERCA suffers no sanction for equivalent errors is patently unfair. This is not to suggest that the tax authorities should be fined for errors (though compensation to taxpayers for egregious errors by ERCA would be in order) but that mistakes by taxpayers should be corrected rather than penalised.

- **Develop a strategy to collect tax:** currently tax is collected in a manner that exacerbates administrative and compliance costs. The absence of a strategy for collecting tax has increased the burden of the private sector and has increased the incidence of penalties.

- **Strengthen systems of taxpayer information and support,** including a comprehensive support web site and information publications made available at all tax offices.

- **Encouragement rather than coercion.** The overwhelming majority of taxpayers, whilst not being enthusiastic about paying tax, recognise that it is their civic
The impact of tax reform on private sector development

• **The rights of the taxpayers have to be respected.** Taxpayers should be treated properly and in accordance with the law and the constitution by tax authorities.

• **Decisions on tax issues must be rendered quickly** and these decisions should be implemented without delay.

• **Where taxpayers keep records, these records must be accepted** by the tax authorities unless evidence of falsehood is found.

• **Business organisations such as Chambers of Commerce and Sectoral Associations should help private sector businesses** to build their capacities to keep adequate records, not just for tax purposes but to help them run their businesses better.

• **There must be fairness, equity and justice in the tax system.**

• **Dialogue:** As shown by this study, taxpayers have multiple problems with regard to tax administration. The institution of a genuine dialogue between the tax authorities and the private sector is imperative in order to restore greater balance to the system.

6.3 Impact of the Tax System on Government Revenues

• The adoption of VAT in 2003/04 has led to a significant rise in the share of revenues generated by consumption taxes. It is clear, however, that this has not been without some adverse effects on private businesses and there remains widespread uncertainty and misunderstanding amongst taxpayers about both the theoretical and practical operation of VAT.

• The tax reform has not adequately addressed the agricultural sector and the informal sector. Indeed, the tax burden on the agricultural sector has fallen significantly in recent years. This has resulted in a weaker revenue generation performance for the government and a higher tax burden on the wealth-generating private business sector – a “lose-lose” situation.

• The Ethiopian economy continues to grow. Government revenues are also growing, but at a lower rate than GDP and are still excessively reliant on foreign trade taxes. Hence, the tax structure needs to strike a balance between the inland revenues and trade taxes. There is little scope to squeeze the private sector further, hence other sectors of the economy must take on a greater burden of revenue generation.

**Recommendation on Impact of Government Revenues**

• **Easing the private sector tax burden:** the agricultural sector and the large informal sector (except the very small and the vulnerable) have to contribute their share in order to alleviate the tax burden on legally registered businesses.
• **Consider the relative role of inland revenues and trade taxes in economic development**: The latter has to be decreased (specifically in relation to capital goods and raw materials as inputs) in order to enhance private sector development.

• **Work jointly with the private sector** in order to simplify problems and tax reform impacts identified in this study to:
  - recognize complex provisions, regulations and implementation processes that can be simplified without a significant loss of revenue or administrative control,
  - draw attention to problems that taxpayers commonly encounter and try to address them through taxpayers’ service, and
  - establish a common understanding of how the ratio of revenue to GDP rises with economic growth.

Finally, yet importantly, the impacts (positive or negative, direct or indirect) of the reformed tax system depend upon the way in which different groups of taxpayers have already perceived the reform and how they are reacting to their perception. It is mutual understanding between the public and the private sector that promotes simplicity, equity and efficiency for effective taxes. The private sector is also required to promote knowledge of public finance (taxation) and the effect of tax laws on production, income, price, saving and investment. The rules of the game in taxation should always be clear to the business community, and those stakeholders concerned about taxation need to work together in a coordinated manner in order to ameliorate the impacts. The perception of taxation in the different groups of society then will be narrowed.
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Proclamation No. 307/2002 Excise Tax Proclamation
Proclamation No. 308/2002 Turn Over Tax Proclamation
Proclamation No. 110/1998 Stamp Duty Proclamation
Proclamation No. 280/2002 Re-enactment of the Investment Proclamation
Proclamation No. 273/2003 Investment (Amendment) Proclamation
A Proclamation to Amend the Stamp Duty Proclamation
A Proclamation to Amend the Income Tax Proclamation
A Proclamation to Amend the VAT Proclamation
A Proclamation to Amend the TOT Proclamation
A Proclamation to Amend the Excise Tax Proclamation

Tax Regulations
Council of Ministers Regulation No. 155/2008 ERCA Employee Regulation
Council of Ministers Regulation No. 78/2002 Income Tax Regulation
Council of Ministers Regulation No. 79/2002 VAT Regulation
Council of Ministers Regulation No. 139/2007 Regulation for the Obligatory Use of Sales Register Machine
Council of Ministers Regulation No. 144/2008 Regulation to Provide the Functioning of Ethics Liaison Units
Council of Ministers Regulation No. 84/2003, the Revised Regulation on Investment Incentives and Investment Areas Reserved for Domestic Investors.
Annex A. Selected VAT Regulations and Schedules

Article 26. VAT Return and Payment of VAT

1) Every registered person is required:
   a) to file a VAT return with the Authority for each accounting period, whether or not tax is payable in respect of that period;
   b) to pay the tax for every accounting period by the deadline for filing the VAT return.

2) The VAT return for every accounting period shall be filed no later than the last day of the calendar month following the accounting period.

3) In cases where a registration takes place with retroactive effect under Article 18, Sub-Article (4)(c), the registered person is required to pay VAT for taxable transactions taking place since the coming into effect of the registration and is entitled to a VAT credit according to credit procedures for registered persons. In addition, the corresponding transactions are to be reflected on the first return filed by the registered person and are considered as taking place during the month to which the return relates. In this event the registered person is entitled to issue VAT invoices for the transactions shown on the return.

4) VAT on taxable imports is collected by the Ethiopian Customs Authority in accordance with this Proclamation and the customs legislation of Ethiopia under the procedure contemplated for customs duty.

Article 27. VAT Refund

1) Subject to this Article, if at least 25 percent of the value of a registered person’s taxable transactions for the accounting period (other than under Article 7 Sub-article (2)(d) is taxed at a zero rate, the Authority shall refund the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within a period of two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

2) Subject to this Article, in the case of other registered persons, the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period is to be carried forward to the next five accounting periods and credited against payments for these periods. Any unused excess remaining after the end of this five-month period shall be refunded by the Authority within a period of two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

3) In all cases where an amount refunded to a person is established by the Authority to have been made erroneously, the Authority may demand the return of such amount.
4) The Minister of Finance and Economic Development shall determine the manner in which and the amount of the tax collections that will he retained for VAT refunds.

5) Where the Authority is satisfied that a person who made an application for refund under Sub-Article (1) or (2) has overpaid tax, the Authority shall:

   a) first apply the amount of the excess in reduction of any tax, levy, interest, or penalty payable by the person under this Proclamation, the Customs Proclamation, the Income Tax Proclamation, or the Sales and Excise Tax Proclamation; and

   b) then repay any amount remaining to the person if the amount to be refunded is more than 50 birr.

6) If a registered person is entitled to a refund under Sub-Article (5) and the Authority is satisfied that the person has overpaid tax, then if the Authority does not pay the refund by the date specified in Sub-Article (1) or (2), whichever is applicable, the Authority shall pay the person entitled to the refund, interest set at 25% (twenty-five percent) over and above the highest commercial lending interest rate that prevailed during the preceding quarter.
### Annex B. Macroeconomic Data

#### Table 6. General Gov

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<th>Particulars</th>
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*Source: Ministry of Finance and Economic Development and own calculation*
### Table 7. General Government Revenue (1998/00-2007/09)

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<td>Tax revenue/total revenue</td>
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<td>5.4</td>
<td>4.8</td>
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<td>4.4</td>
<td>3.8</td>
<td>1.6</td>
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<tr>
<td>Indirect tax/total tax</td>
<td>66.1</td>
<td>65.5</td>
<td>65.3</td>
<td>61.7</td>
<td>64.5</td>
<td>70.2</td>
<td>68.3</td>
<td>65.5</td>
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<td>70.5</td>
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<td>Domestic indirect/indirect tax</td>
<td>33.6</td>
<td>35.0</td>
<td>29.4</td>
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<td>28.6</td>
<td>32.1</td>
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<tr>
<td>Foreign trade/indirect tax</td>
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<td>70.6</td>
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<td>68.1</td>
<td>71.4</td>
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<td>69.7</td>
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<tr>
<td>Non-tax/total revenue</td>
<td>41.6</td>
<td>36.8</td>
<td>30.3</td>
<td>24.7</td>
<td>26.4</td>
<td>20.2</td>
<td>20.5</td>
<td>26.6</td>
<td>20.4</td>
<td>20.1</td>
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<td>Share of GDP</td>
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<tr>
<td>Direct income tax</td>
<td>3.20</td>
<td>3.48</td>
<td>3.96</td>
<td>4.82</td>
<td>4.22</td>
<td>3.96</td>
<td>4.01</td>
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<td>Indirect Tax</td>
<td>6.25</td>
<td>6.61</td>
<td>7.46</td>
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<td>7.67</td>
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<td>Non-Tax Revenue</td>
<td>6.73</td>
<td>5.88</td>
<td>4.97</td>
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<td>4.26</td>
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<td>3.26</td>
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<td>Agriculture tax/Agriculture GDP</td>
<td>0.45</td>
<td>0.38</td>
<td>0.40</td>
<td>0.48</td>
<td>0.25</td>
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<td>0.33</td>
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*Source: MoFED and own calculation*
C1. Cash Accounting Scheme for VAT

Using standard VAT accounting, you pay VAT on your sales whether or not your customer has paid you. Using cash accounting, you do not need to pay VAT until your customer has paid you. If your customer never pays you, you never have to pay the VAT. Using standard VAT accounting you:

- pay VAT on any invoices you have issued, even if you have not received the payment from your customer;
- reclaim VAT on any invoices you have received, even if you have not yet paid your supplier.

Using the Cash Accounting Scheme, you:

- pay VAT on your sales when your customers pay you;
- reclaim VAT on your purchases when you have paid your suppliers.

You can use the Cash Accounting Scheme if your estimated VAT taxable turnover during the next tax year is not more than £1.35 million. Your VAT taxable turnover includes any standard, reduced and zero-rated sales and other VAT taxable supplies, but excludes VAT itself, supplies that are exempt from VAT, and capital asset sales.

Once you start to use cash accounting, you can continue to do so until your VAT taxable turnover reaches £1.6 million. You cannot use cash accounting if:

- you are not up-to-date on your VAT Returns and VAT payments;
- you have been convicted of a VAT offence or charged a penalty for VAT evasion in the last year;
- your VAT taxable turnover is over £1.35 million per year.

Benefits of cash accounting

Using cash accounting may help your cash flow, especially if your customers are slow payers. You do not need to pay VAT until you have received payment from your customers. So if a customer never pays you, you don’t have to pay VAT on that bad debt as long as you continue to use the Cash Accounting Scheme.

Source: Her Majesty’s Revenue & Customs, www.hmrc.gov.uk
C2. Flat Rate Scheme for VAT

If your VAT taxable turnover is less than £150,000, you could simplify your VAT accounting by calculating your VAT payments as a percentage of your total VAT-inclusive turnover. Although you cannot reclaim VAT on purchases – it is taken into account in calculating the flat rate percentage – the Flat Rate Scheme can reduce the time that you need to spend on accounting for and working out your VAT. Even though you still need to show a VAT amount on each sales invoice, you don’t need to record how much VAT you charge on every sale in your accounts. Nor do you need to record the VAT you pay on every purchase.

Using standard VAT accounting, the VAT you pay or claim back is the difference between the VAT you charge your customers and the VAT you pay on your purchases. Using the Flat Rate Scheme you pay VAT as a fixed percentage of your VAT inclusive turnover. The actual percentage you use depends on your type of business.

You can join the Flat Rate Scheme for VAT and so pay VAT as a flat rate percentage of your turnover if:

- Your estimated VAT taxable turnover - excluding VAT - in the next year will be £150,000 or less. Your VAT taxable turnover is the total of everything that you sell during the year that is liable for VAT. It includes standard, reduced rate or zero rate sales or other supplies. It excludes the actual VAT that you charge, VAT exempt sales and sales of any capital assets.

Generally you don’t reclaim any of the VAT that you pay on purchases, although you may be able to claim back the VAT on capital assets worth more than £2,000 - see the section in this guide on claiming back VAT on capital assets for the rules and restrictions. Once you join the scheme you can stay in it until your total business income is more than £225,000.

Benefits of using the Flat Rate Scheme

Using the Flat Rate Scheme can save you time and smooth your cash flow. It offers these benefits:

- You don’t have to record the VAT that you charge on every sale and purchase, as you would with standard VAT accounting. This can mean you spending less time on the books, and more time on your business. You do need to show VAT separately on your invoices, just as you do for normal VAT accounting.

- Fewer rules to follow. You no longer have to work out what VAT on purchases you can and can’t reclaim.

- Peace of mind. With less chance of mistakes, you have fewer worries about getting your VAT right.

- Certainty. You always know what percentage of your takings you will have to pay in tax.
Potential disadvantages of using a Flat Rate Scheme

The flat rate percentages are calculated in a way that takes into account zero-rated and exempt sales. They also contain an allowance for the VAT you spend on your purchases. So the VAT Flat Rate Scheme might not be right for your business if:

- you buy mostly standard-rated items, as you cannot generally reclaim any VAT on your purchases
- you regularly receive a VAT repayment under standard VAT accounting
- you make a lot of zero-rated or exempt sales.

Source: Her Majesty’s Revenue & Customs. [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

C3. Annual Accounting Scheme for VAT

Using standard VAT accounting, you must complete four VAT Returns each year. Any VAT due is payable quarterly, and any VAT refunds due to you are also repayable quarterly.

Using annual VAT accounting, you make nine interim payments at monthly intervals, or three quarterly interim payments, throughout the year. You only need to complete one return at the end of the year when you either make a balancing payment or receive a balancing refund. Annual accounting can reduce your paperwork and make it easier to manage your cash flow.

Using standard VAT accounting, you must complete four VAT Returns each year. Any VAT due is payable quarterly, and any VAT refunds due to you are also repayable quarterly.

Using the Annual Accounting Scheme, you make either nine interim payments at monthly intervals, or three quarterly interim payments, throughout the year. You only need to complete one return at the end of each year. At that point you must pay any outstanding amount. If you have overpaid, you will receive a refund.

You can use the Annual Accounting Scheme if your estimated VAT taxable turnover for the coming year is not more than £1.35 million. Your VAT taxable turnover includes any standard, reduced and zero-rated sales and other VAT taxable supplies, but excludes the VAT itself, VAT-exempt supplies and capital asset sales.

Once you are using annual accounting you can continue to do so as long as your estimated VAT taxable turnover remains below £1.6 million.

Benefits of annual accounting

- you only need to complete one VAT Return per year, instead of four
- you get two months rather than one month to complete and send in your annual VAT return and pay the balance of your VAT payable
• you can better manage your cash flow by paying a fixed amount in monthly or quarterly instalments
• you can make additional payments as and when you wish
• you can join from the day you register for VAT, or if you are already registered

**Disadvantages of annual accounting**
• if you regularly reclaim VAT, you will only get one repayment per year
• if your turnover decreases, your interim payments may be higher than your VAT payments would be under the standard VAT accounting - you would have to wait until the end of the year to receive your refund

*Source: Her Majesty’s Revenue & Customs. [www.hmrc.gov.uk](http://www.hmrc.gov.uk)*