Assessment on the Value Added Tax Implementation in Ethiopia

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Abstract

Since the major shift in economic policy from the command economy to market oriented economic system in 1992/93, the Government of Ethiopia has taken a series of tariff and tax reform measures with the objective of doing away outdated tariff and tax laws, to strengthen customs and tax administration, to improve the balance of trade, to attract domestic and foreign direct investment, to facilitate trade and liberalize trade, and to generate adequate revenue to cover current and capital expenditures , hence to finance poverty reducing projects and development in general. During the period of 1993/94 to 2002/03, the Federal revenue to GDP ratio has increased from 8.97% in 1993/94 to 11.87% in 2002/03 while national tax revenue to GDP ratio has increased to 15.1% in 2003/03 from 10.9% in 1993/94. Despite the reduction of tariff and taxes which resulted in the increase of revenue, however, government expenditure has been increasing and budgetary deficit with and without grants has been widening which has led to more borrowing and indebtedness. As a result the external debt to GDP ratio has increased from 70.4% in 1993/94 to 102.9% in 2002/03. As is the case internationally, the Value Added Tax (VAT) was introduced since January 1/2003 with the objectives of reducing distortions by other indirect taxes, to compensate for import tariff revenues lost as a consequence of trade liberalization and due to Government's need to increase its revenue. During the fifteen months of the implementation of VAT, there is an indication that the tax will bolster revenue as the C-efficiency ratio rises. However, the current increase in VAT collection has been generated from a compliance level of 28% out of 8512 registrants up to March/2004, the balance being nil-filers, non-filers and stop filers. Coupled with many unregistered liable businesses, it seems that the tax base has been eroded. Though, collection of VAT at customs entry point doesn't have any problem, the tasks of the Federal Inland Revenue Authority in the identification and registration of taxpayers, processing returns, controlling collection, securing delinquent declarations and collection of tax arrears, making refunds, auditing taxpayers, investigation for tax fraud and evasion, and levying administrative penalties and following up of tax offences have to be revisited and revitalization measures taken in order for VAT to live up to the expectation as an efficient and fair source of revenue.

I. Introduction

Since 1992/93, the Government of Ethiopia has made a major economic policy shift from Central Planning to market oriented economic system. In line with this change, a series of tariff and tax reform measures have been taken. The reasons to these were: outdated tariff and tax laws; weak customs and tax administration; failure of the tariff and tax regime to attract investment, to facilitate trade and to generate adequate revenue to cover current and capital expenditure, and hence finance development and poverty reducing projects.

The series of tariff and tax reform programs have helped to increase both Federal Government and national revenue. As per the reports of the Ministry of Revenue, the Federal Revenue has increased to Birr 6.7 billion in 2002/2003 from Birr 2.54 billion in 1993/94 as the result of which federal revenue as percentage of the GDP increased from 8.97% in 1993/94 to 11.87% in 2002/03. (REPIM, 2004). The increase in revenue mainly attributes to the modest increase in both direct and indirect taxes, mainly the foreign trade taxes. As well, National tax revenue as percentage of GDP has increased to 15.1% in 2002/03 from 10.9 in 1993/94. Despite, the series of reforms and increase in revenue, the overall budget deficit with and without grant has been increasing. For example, the overall budget deficit without grants as percent of GDP has increased from -5.2% in 1996/97 to -14.5% in 2002/03 (NBE, 2002/03). This shows that performance of revenue collection in Ethiopia has been low compared to the rest of Sub-Saharan African countries which is over 23% of the GDP.

Hence, coupled by a series of reduction in the import tariff, excise tax and income tax and widening of the budgetary deficit, introducing a neutral and efficient tax, i.e. the VAT with broad tax base was considered.

Value Added Tax (VAT) has become a major tax instrument worldwide. The global trend to introduce VAT in more countries is continuing. VAT has also become an indispensable component of tax reforms in developing countries (Goode, 1993). Ethiopia's tax reform program has introduced VAT since January, 2003.

VAT revenue performance and its neutrality and efficiency are also the reasons for superiority of this tax in contrast to other common tax instruments such as the turnover tax (Zeljko & Fareed, 1993). The emerging conventional wisdom, based largely on practice and numerous country case studies, suggests that a single rate VAT (with the rate between 10 and 20%), with very few exemptions and, therefore, a broad base is superior to a VAT with multiple rates and many exemptions which reduce its base and complicate administrations. Ethiopia's standard VAT rate of 15% and 10% equalization for services and 2% for goods have to be studied in the medium term whether or not they could broaden the tax base and register high revenue performance.

The objective of this paper is not to carry out poverty and social impact analysis which has already been done by Sonia Munoz and Stanley Sang-Wook Cho (2003) and REPIM* (2004). It rather assesses the status of VAT implementation in Ethiopia since January, 2003. It dwells on the administration and compliance aspects of the tax. Specifically, the author seeks to answer the following questions. Do all who are liable for registration have been registered? What is the discipline of payment? What is the revenue performance? Is the administration strong?

The structure of the paper is as follows. Section II presents the trend of Government Revenue, Expenditure, Budgetary Deficit and External Debt, Section III the evolution of VAT in the international context; Section IV provides a brief, stylized overview of the major ingredients of the VAT proclamation of Ethiopia, Section V looks into the administration aspects of VAT. Section VI focuses on VAT rate, Base and Revenue performance. Section VII explores the discipline of taxpayers and, the last Section, Section VIII, contains concluding remarks and policy recommendations.

** REPIM= Research on Economic Policy Implementation and Management, Northumberland, England*

II. The Trend of Government Revenue, Expenditure, Budgetary Deficit and External Debt

Over the past ten years, since 1993/94 to 2002/03, with growth in the GDP, the amounts of tax, non- tax revenue and grants were increasing. Tax revenue increased from Birr 3 billion in 1993/94 to Birr 8.2billion in 2002/03; while the amount of non-tax revenue and external grants increased from Br 862.4 million to 1.7 billion and Br987.2 million to 2.45billion respectively over the same period. This has increased total revenue and grants from Birr 4.93billion in 1993/94 to Birr 13.6 billion in 2002/03. However, despite this increase, the total revenue and grants couldn't catch up with the increase in the amount of total current and capital expenditure, as a result which the overall deficit including and excluding grants has been widening (Annex 1).

The amount of total current and capital expenditures have increased from Birr 4.34 billion and Birr 2.70 billion to Birr 12.3 and Birr 5.8 billion respectively, as a result of which total expenditure increased from Birr 7 billion to Birr 18.4 billion over the years in reference. This has widened the budgetary deficit and also contributed to the increase in the disbursed external debt. Overall budgetary deficit including grants has increased from the lowest of Birr 635 million in 1996/97 to Birr 4.77 billion in 2002/03, while the ratio of external debt to GDP increased from 90.8 % to 107.3% during the same period. As depicted in the following figure 1, external debt has surpassed GDP since 2001/2002. Total expenditure has been over and above total revenue and grants. This trend, therefore calls for further reform of the revenue sector, specially the introduction of the value added tax with broader tax base since January 1/2003.

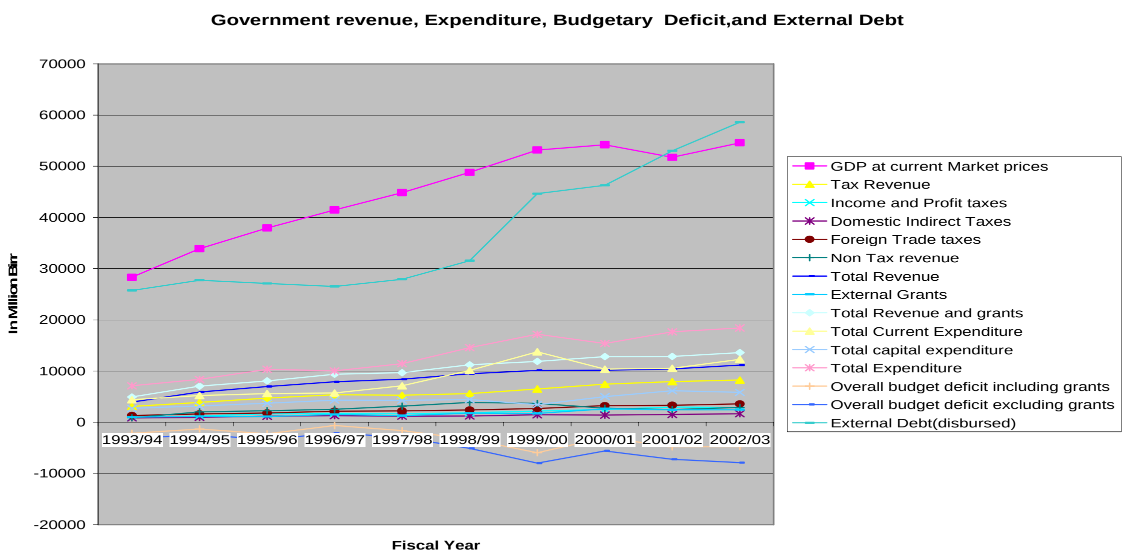


Figure 1:- Government Revenue, Expenditure, Budgetary Deficit and External Debt

III. The Genesis of VAT

The Value Added Tax (VAT) is a tax on the value that a business firm adds to the things it buys from other firms in producing or distributing its product or service. A VAT is "restricted" or "pre-retail" if it doesn't extend through the retail stage and it is "comprehensive" if it covers all economic activities right through to the retailer. Hence, it is broad based tax levied at multiple stage of the production and distribution chain. It is neutral, as the total accumulated tax, down through the retailer is the same for every unit of currency of retail price, no matter how the values added that make up of the unit of currency are distributed among the stages of production and distribution. Also taxes on inputs are credited against taxes on output (Carl Shoup, 1988). Distortions associated with domestic indirect taxes combined with governments' need to replace/increase their revenues lost as a consequence of import tariff reduction due to trade liberalization created an incentive for the introduction of VAT in many countries (Victoria Summers etal, 2002).

The VAT evolved in the more developed countries of Europe and Latin America. The first proposal emerged in France in the 1920s and was recognized in 1948. Brazil from Latin America, Denmark from Europe adopted VAT in 1967. Through time, this tax spread rapidly in South America and the industrialized world until late 1970s. The developing and transition economies adopted the tax in the 1980s and 1990s. For example, the number of African Countries that introduced VAT increased from 2 to 30 in the 1990s (Victoria Summers etal, 2002).

Table 1: <u>The Implementation of VAT Internationally</u>

Year	Sub-Saharan Africa (43)	Asian and Pacific(24)	EU(plus Norway and Switzer-land(17)	Central Europe & BRO*(26)	North Africa and Middle East(21)	Americas (26)	Small Islands	Total
2001 (April)	27	18	17	25	6	22	8	123
1989	4	6	15	1	4	16	1	47
1979	1	1	12	0	1	12	0	27
1969	1	0	5	0	0	2	0	8

Source: IMF, Finance & Development, June 2002, Vol.30, No. 2

- ***BRO= Baltic states, Russia, and other countries of the former Soviet Union***

The rapid widespread and rise of the VAT is still the most dramatic and most important development in taxation in the latter part of the twentieth century and even now. As to Victoria Summers etal (2002) the reasons to this development are:

- To do away distortions created by other indirect taxes;
- Government's need to increase their revenue and
- To replace import tariff revenues lost as a consequence of trade liberalization.

This incentive to seek less distortionary alternatives paved the way for the introduction of VAT, first slowly and then rapidly at a latter moment.
According to Victoria Summers etal (2002), the spread of VAT appears to have been desirable and successful, but requires good design and implementation, not only when first adopted but also for many years after. If VAT is correctly designed, it will live up to the expectation as an efficient and fair source of revenue. Findings up to now suggest that the VAT bolster revenues efficiently. According to experts in the field, the C-efficiency ratio is a better measure of VAT effectiveness.

IV. Overview of the VAT Proclamation & Regulation

The VAT proclamation No 285/2002 was issued on 4th July 2002 by the council of representatives to become into force as of 1st January 2003. The proclamation has 13 sections and 66 articles.

According to this proclamation taxpayers are those persons registered or required to be registered; persons carrying out taxable import of goods to Ethiopia, non-resident persons who perform service without registration for VAT and who are subject to taxation according to the proclamation. As to this proclamation, all persons who are registered are taxpayers from the time the registration took effect and certification of registration is issued. Persons who are not registered but who are required to be registered are also considered as taxpayers from the beginning of the accounting period following the period in which the obligation to apply for registration arose.

Subject to this proclamation, supply of goods means sales of goods; a grant of the use of or right to use goods; and a transfer of provision of thermal or electrical energy, gas or water. A rendition of services also include anything done which is not supply of goods or money including the granting, assignment, cessation, or surrender of any right or making available a facility or advantage.

As to article 7.1 of this proclamation every taxable transaction by registered person and every import of goods (other than an exempt import) and an import of services by any VAT registered customer in Ethiopia or any resident legal person is liable to a Value Added Tax of 15%. However, the export of goods and services to the extent provided in the VAT regulation; the rendering of international transportation of goods or passengers, as well as the supply of lubricants and other consumable technical supplies taken on board for consumption during international flights; the supply of gold to the National Bank of Ethiopia, and a supply by a registered person to another registered person in a single transaction of substantially all of the assets of a taxable activity or an independent functioning part of a taxable activity as a going concern are zero rated.

Due to social, economic and developmental reasons, exempt transactions from VAT include: the sale of a used dwelling or the lease of a dwelling, the rendering of financial services, the supply or import of national or foreign currency, the rendering of religious services, the import or supply of drugs, educational services, the supply of goods and rendering of services in the form of humanitarian aid, the supply of electricity, kerosene, water, goods imported by governmental organization, institutions and projects exempted from duties, post office supplies, printed books and other printed materials, the import of goods to the extent provided under schedule II of the customs tariff regulation, the supply of goods by workshops for the disabled; food items like bread, injera, milk, agricultural inputs, construction contracts concluded with government institutions before 1st January 2003.

The registration for VAT is both obligatory and voluntary. Under the obligatory registration, a person who carries on taxable activity and is not registered is required to file an application for registration if his annual taxable transaction exceeds Br 500,000 (US$58,100). Those persons who are required to register are also expected to fill an application for registration. Persons, who carry on taxable activity and are not required to be registered for VAT, may voluntarily apply for registration, if they regularly supply or render at least 75% of their goods and services for registered persons.

According to Article 22 of the VAT proclamation all persons registered for VAT are required to issue a VAT invoice to the person who receives the goods or services. There are cases where a receipt or simplified from of VAT invoice may be used depending on the value of transaction and type of transaction involved. Those unregistered do not have the right to issue a tax invoice.

VAT is collected by the Federal Inland Revenue Authority, VAT Department in Addis Ababa and the branches; and at customs stations of the Ethiopian Customs Authority at importation of goods.
When VAT is not returned accordingly, the Federal Inland Revenue Authority may seize property to collect the tax due. The seizure shall extend only to property possessed and obligation existing at the time the seizure is made. The seized property could be sold at public auction or in any other manner depending on the nature of the goods to be sold to recover uncollected tax. No other agency of the government may require the property seized to be transferred or given over to it for any cause what so ever. Nevertheless, portions of the proceeds in excess of the liabilities shall be returned to the owner. In this process, FIRA will only use the powers of attachment and seizure as a last resort. The tax payer will be afforded every opportunity to make payment arrangements before the enforcement action is taken.

Some of the violations of the proclamation are administrative and there are administrative penalties and interest, applicable to failure to file, failure to pay, failure to maintain the required books and records etc. The rest of the violations of this law are tax offences hence shall be charged, prosecuted, and appealed in accordance with the Ethiopian Criminal law. Tax evasion, making false and misleading statements, obstruction of administration, failure not to notify changes in addresses and line of business, unauthorized VAT collection, aiding or abetting, offences by entities, offences by receivers, improper tax debit and tax credit are subject to prosecution, and on conviction subject to monetary fine and imprisonment ranging from not less than 1 to not more than 15 years.

Any tax officer or former taxation officer employed in carrying out the provisions of this proclamation who commit offences is subject to monetary fine and imprisonment of not less than 10 years and not more than 20 years.

Except for problems of tax compliance; delay of computerization and some weaknesses in the administrative setup of VAT Department, the implementation has been smooth. The Ministry of Revenue and FIRA have done a good job and avoided most of the problems encountered by other countries for example Ghana in 1995 (World Bank, 2001). Since strong and clear political management was crucial for the implementation of the VAT, extensive consultation with stakeholders, comprehensive taxpayer education and information programs have been conducted which resulted in more tax registrants (8512) than the initially expected number of taxpayers (3500).

V. Main Issues of VAT Administration

The main tasks that must be performed by any department in charge of VAT are: identification and registration of taxpayers, processing returns, controlling collections, securing of delinquent declarations and collection of tax arrears, making refunds, auditing taxpayers, investigations for tax fraud and evasion, and levying penalties. In order to administer these tasks, the department in charge has to be well organized and conduct publicity and tax payers' education and information during the lead-in time. Enough lead-in time is necessary to permit careful preparation of regulations, return forms, and systems for registration of taxpayers and processing of VAT returns and payments. The Ethiopian experience is evaluated in connection to these dimensions as follows.

5.1. Organizational structure, staffing and training

One of the major decisions that should be taken in preparation for the introduction of the VAT is a choice of organization and organizational changes to administer the VAT, staffing requirements and staff training. In some countries, customs organizations are assigned to administer the VAT. In others either they establish a separate organization due to their conviction that the modern nature of the tax would make it difficult to administer by the existing conventional and somewhat antiquated methods, or integrate it with the income tax administration taking into account better planning and coordination of enforcement efforts and use of current tax audit expertise. In others, if the tax administration is organized by functional lines and a general sales tax was previously in force, a VAT Unit shall replace the sales tax unit. In the Ethiopian case, as the FIRA was not only organized along functional lines, setting up a special VAT unit in FIRA was a necessity.

Along this line, there were efforts to design the organization structure and to determine the number of staff to be trained and deployed. Some have been taken from the ex-sales tax unit, some have gone from the tax reform program and the Ministry of Revenue and some have been newly recruited.

At present, the newly introduced Value Added Tax is administered by a newly established department located at the Mexico square and some branches in the country and by the Ethiopian customs Authority. The new department in FIRA is answerable to the General Manager. Currently the department is staffed with 62 employs out of the approved 80. The staffs are graduates of accounting, economics and the management profession. The organo-gram and staff assignment is depicted in the following diagram.

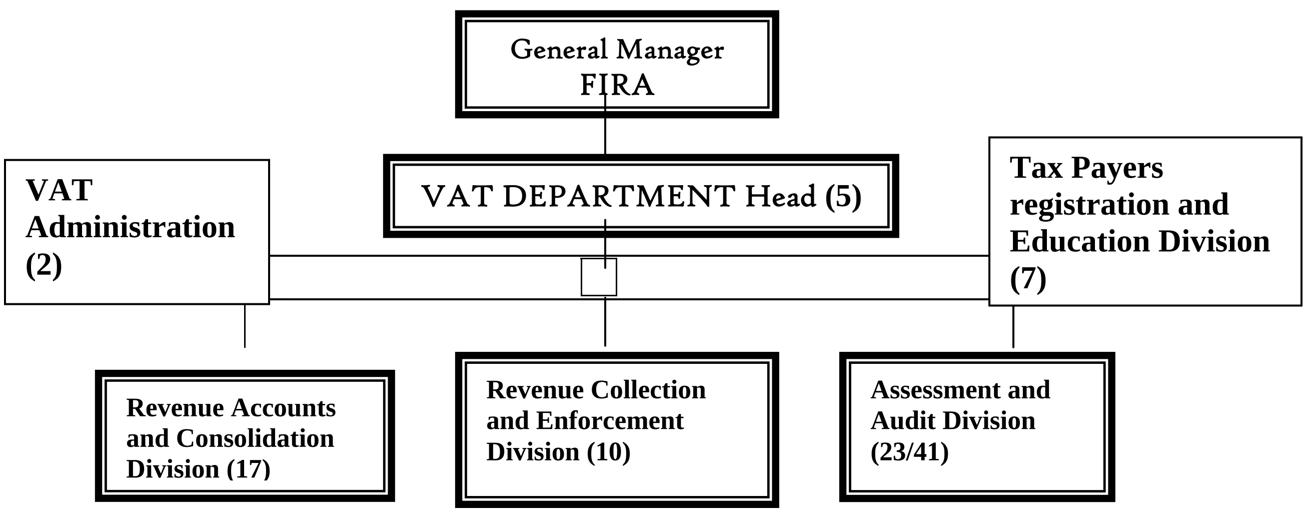


Diagram 1:- Organo- gram of the VAT Department

In addition to this department in Addis Ababa, VAT sections with a maximum staff of six employees are deployed in the branches of Nazareth, Dire Dawa, Awassa and Bahir-dar respectively. The Jimma and Mekelle branches have 4 VAT officers each. In general, the current total staff deployment to implement and administer the newly introduced VAT are 94, which is almost 10% of the total staff of FIRA, while the department and the respective branches collect close to 40% of the total revenue by FIRA. Even though, the VAT is computerized, considering the current and future challenges, the VAT department requires additional personnel in all areas- taxpayer education and service, accounting and collection, enforcement and audit. Efforts currently underway within the Ministry and FIRA to strengthen the VAT administration, to improve service delivery, training of staff should continue to address the shortfall encountered. Specially, the administration should focus in strengthening its audit and enforcement wings.

5.2. Tax Payer's Identification/Registration and Computerization

A single Tax payers' identification number for all taxes is a useful tool for effective tax administration. A taxpayer will use the same number in his income tax return, for VAT purposes, for withholding tax, and to pay his property tax. The TIN could also be used in the dealings of the taxpayer with customs administration. The TIN could be any of the three types: sequential, biographical or a combination of the two. In countries where there was a unique tax identification number or sales tax identification number, taxpayers were not required to register again. In some countries different numbers are used for different taxes. In the Ethiopian case, except the trade license number issued by the Ministry of Trade and Industry, there has never been either a unique tax identification number or publicly known sales tax payers' number. Hence, all legible VAT taxpayers have been required to register for VAT and get their numbers until such a time the delayed TIN project is becoming operational. Currently, the TIN system has become operational in the FIRA (Addis Ababa branch, LTO, Nazareth, Awassa, Mekelle), Addis Ababa City Administration and Oromia. The target is to have TIN issued to all VAT taxpayers this fiscal year.

The registration for VAT has started manually and then processed through a locally developed interim VAT computerized system until the SIGTAS started operation. The interim system had met the basic requirements of the FIRA -VAT department, such as registering taxpayers and issuing certificates, processing payments and declarations, revenue and taxpayer accounting etc... The SIGTAS, which contains every taxpayer transaction, started in Addis Ababa in February/2004 and is expected to be operational nationally this fiscal year.

Table 2: Distribution of VAT Registrants in the Country (2003-2004)

	Feb 2003	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec 2003	Jan-March/04	Total	%
A.Ababa	2833	331	131	112	76	142	161	123	257	203	357	1272	5998	70.5
Oromia	290	58	35	48	40	55	26	13	66	203	139	191	1164	2.8
Amhara	66	27	12	7	11	18	10	16	15	14	19	12	227	13.7
Tigray	79	23	11	13	2	12	14	7	10	11	10	10	202	2.4
SPNN	182	98	10	11	22	15	7	39	59	98	50	57	648	7.6
Afar	5		-	1	-	-	6		6	1	-	-	19	0.2
Harar	11	6	-	5	4	-	1		3	2	2	6	40	0.5
Dire Dawa	55	6	6	5	4	4	1	3	15	3	3	18	123	1.5
Benishangul	-	1	-		-	1	2	3		-	-	-	7	0.1
Gambella	1	2	1		3	-	1			1	1	4	14	0.2
Somalia	1	2	21	12	11	3	9	2	1	2	4	2	70	0.8
	3523	554	227	214	173	250	238	206	432	538 6355	585 6940	1572	8512	100 %
	41.4 %	6.5 %	2.7 %	2.5%	2.0 %	2.94 %	2.8 %	2.42%	5.08%	6.3%	6.9%	18.5 %	100 %	

Source: FIRA VAT Department, and Plan & research department of MoR

As can be seen from the table above, by the end of March/2004, the number of registrants has reached the tune of 8512 from 3523 in February 2003. Out of the total of 8512 registrants, 70.5% are in Addis Ababa, 13.7% in Oromia, 7.6% in Southern peoples Nations and Nationalities, while the remaining 8.2% is attributed to the rest of the regions.

The initial plan to register 3500 was due to the intention to work with a lower population base with a threshold of Birr 500,000 which was deliberately set at a much higher level than most countries, primarily based on the recommendation of the IMF. Though this was the initial plan of taxpayers for VAT registration, it has been advised by the trading community that the number should be much higher as Br 500,000 turnover per annum means nothing even for small kiosks. Hence, based on this advice and taking into account the data on the number of business in this country, The Ministry and FIRA took some enforcement actions which resulted in some improvement in the number of taxpayers registered at the end of March/2004. However, the number of registrants for VAT is still low in Addis and the regions. According to FIRA's recent announcement, most importers have not been registered for VAT but are still importing goods through customs. The directives for registration and compliance successively issued from the Ministry of Revenue and the FIRA are really appreciated. Nonetheless, still the FIRA should pursue to work with Trade, Finance and Revenue Bureaus of Addis Ababa and regional states to mine those who still didn't register for VAT. Registration on sect oral level could simplify the identification of legible VAT registrants.

According to the 2nd Annual Report on the Ethiopian Economy by EEA, and the Reports on small scale and cottage/handicraft manufacturing by the CSA, there are over 779 large and medium scale manufacturing industries, over 31,863 small scale manufacturing establishments, and over 974,676 cottage/handicrafts manufacturing industries respectively. Also the data from the Customs ASYCUDA indicate that the importers file shows that about 20,864 have been importing through customs out of which 6,874 are very active and enjoy importation of over Br14 billion. Coupled with the number of wholesalers and retailers business, Bars and restaurants, Gold and copper smiths etc... One can easily estimate what the number of registrants for VAT and TIN should be.

5.3. Invoicing and Bookkeeping requirements

In all countries that have implemented the VAT, bookkeeping requirements are almost the same. Nevertheless, there are differences in invoicing. In most industrialized countries, invoices are required to be issued for transactions between VAT taxpayers. Most developing and least developed countries that introduce the VAT, by contrast, require some form of invoicing for all transactions on which VAT is charged, including sales to final consumers by using a simplified form of invoice or a cash register receipt. Some Latin American Countries like Mexico have introduced a system to encourage consumers to request invoices by holding lotteries in which invoices are the tickets. Even though, there are complaints from the side of businessmen that this adds to VAT compliance costs, most tax authorities in developing countries believe that this is essential for VAT enforcement. Also there is a conviction that when traders are required to issue invoices to final consumers they will not understate their sales and in turn gives them an incentive to demand invoices from their suppliers. This system, therefore, enhances compliance costs of suppliers and retailers.

In the Ethiopian case, the Commercial Code of 1960 of Ethiopia Article 63/1 states that" Any person or business organization carrying out trade shall keep such books and accounts as are required in accordance with business practice and regulations, having regards to the nature and importance of the trade carried on". Article 20/1-2 of Income tax regulation No. 78/2002 also stipulates that business should get their invoices printed by a printing press after getting approval from the FIRA. However, except on some audit assignments, the follow up on this issue is not that much strong and no reports are inquired from printing presses from the side of FIRA. Also Article 37 of VAT proclamation requires VAT registrants to keep records of account for at least 10 years.

On top of this, according to VAT proclamation no.285/2002 article 22/1 stipulates that a person registered for VAT is required to issue a VAT invoice for a taxable transaction. However, the practice of holding books and accounts and issuing invoices has a mixed picture in this country. State Owned Enterprises, some private share companies and Limited companies hold true accounts. According to a recent investigation report most businesses hold two books: one for the tax Authority and another for Banks. Usually, the financial statements produced to the tax Authority are highly understated and to banks overstated. Hence, give a wrong picture of the business be it on VAT returns and income taxes. In relation to issuing invoices, the tax Authority has discovered sellers that do not use invoices designed and prescribed by the FIRA and even if they did, have been found dealing with buyers to offer them lower price if they do not request for a VAT invoice and issue invoice at higher price if VAT invoice is requested. Other businesses also issue fraudulent invoices using invented VAT numbers of their own and collect VAT for their own. In order to solve this problem of invoicing at the retail level, the experience of the Latin American Countries might help a lot. To that effect, the FIRA could decide on the type of electronic cash registers to be used by retailers on a net work with the SIGTAS, and agree with the National Lottery Administration on the type of lottery holding invoices to be used by retailers.

Although, the TOT is intended to tax the value added on the final sale by below-the-threshold businesses to the consumer that would otherwise escape the VAT, complaints by bona fide traders indicate that the 2% equalization tax has distorted competition as the sources of goods for both who have registered for VAT and for those who are not registered is the same. However, the equalization tax of 2% should not be seen as market distorting as those who pay 2% TOT do not get refunds for their inputs while VAT tax payers get their refund. But, if there are justifiable and convincing reasons, the Ministry of Finance and Economic Development should consider looking into the level of the threshold and revising it on the basis of Article 16/2 which gives mandate to the Ministry either to increase or decrease the threshold. But, to effectively administer a large number of registrants, the organizational set up of FIRA has to be reinforced and as well the business community should adhere to the Commercial law of 1960 and to the different tax laws and keep books and accounts which are part of the pre-requisites for VAT registration.

5.4. Control of filing and payment

According to Proclamation No. 285/2002, Article 26/1, every registered person is required to file VAT return with the FIRA for each accounting period and to pay the tax for every accounting period by the deadline for filing the VAT return. As to Article 26/2, the VAT return for every accounting period shall be filed no later than the last day of the calendar month following the accounting period. However, VAT on taxable imports is collected by the Ethiopian Customs Authority in accordance with Proclamation No. 285/2002 Article 14, 15/1-2 and Customs Proclamation 60/1997 under the procedure contemplated for customs duty. Hence, VAT collections at Customs are made by C.P.O. and are deposited to Government Account the next morning of its collection. In general, what is practiced in Ethiopia is monthly filing and payment of VAT which means that VAT taxpayers are required to pay each month for the sales they made the previous month and every day for imports through customs. Hence, by law there is one month collection lag at FIRA while there is no lag at customs. But, in practice the lag in collection is over one month in FIRA.

In relation to controlling and filing of VAT, the FIRA made some use of an interim computerized system until the main computerized system is launched. However, in the process it has migrated to the core VAT computerized system called Standard Integrated Government Tax Administration System (SIGTAS) developed by SOGEMA of Canada.

This integrated tax administration system could be of use to register VAT tax payers, to process returns, credits and refunds, to detect non-filers, and stop-filers, to conduct effective auditing, statistics and reporting. Hence, now detection of non-filers and stop-filers could not be delayed putting in jeopardy collection of delinquent taxes if the audit and enforcement wings are strong.

5.5. Audit of VAT

The overall impression of experts in VAT is that considerable evasion exists in developing and least developed countries by means of under-reporting of sales, abuse of the credit mechanism (by using falsified invoices), and fraudulent refund claims. Hence, the tool to cope with evasion of VAT is the introduction of a "built-in" checking mechanism of the tax, i.e. Audit of VAT guided by a clear Audit Manual. Developing procedures for comparing data on purchases and sales by various taxpayers is very important. Data processing system with massive cross-checking operations would contribute a lot to VAT auditing. Checks of invoices, particularly to ascertain whether credits against the VAT liability are supported by bona-fide invoices rather than falsified documents have proved useful for detecting taxpayers that merit further investigation.

Import data provided by the Customs department can be used to select taxpayers for audit. Checking the list of suppliers to government Ministries, Agencies, institutions, and enterprises is also effective. In several countries under-payments of VAT have been discovered among firms that sell to the Government. In addition to these, several countries enforce control of VAT by checking inventories of goods on hand and inspecting merchandise in shops, warehouses, storerooms, and other business premises. Truckers transporting goods are required to carry consecutively numbered manifests corresponding to invoices. VAT Audit programs should be designed to distribute available audit resources among large number of taxpayers. To this end, however, FIRA's plan to interface its SIGTAS and TIN with ASYCUDA++ of customs, banks and other relevant institutions has to be pursued. Also, the FIRA should put in place a risk management system/ an effective audit selection system/ which will be used to conduct audits based on relative risk of revenue loss. To this end, the Authority should deploy adequate trained staff, and the auditors must be facilitated to have access to more information than just included in the return. Currently, the department has only twenty three out of the forty. Even if we assume that all the forty are deployed in the Addis Ababa VAT department and conduct audit on at least 24 taxpayers' account every year, the total audit per year would be on 960 taxpayers only, which will be only 16% of the current registrants. But, in practice, the audit department of VAT has audited only 125 taxpayers during the first six months of 2003/04 fiscal year. This could be a very dangerous beginning, as it would invite the taxpayers not to be compliant due to the weakness of the tax audit. As it is internationally recommended, the Government should allow the tax authority to utilize about 1to 2% of its collection for adequate deployment of staff and materials and conduct audits effectively. If a measure to deploy at least 200 auditors with a minimum of 50 taxpayers each is not done as soon as possible, the FIRA will put itself in a grave situation of un-audited tax files as the number of VAT registrants increase, which in the final analysis means shortfall in tax collection. Therefore it is high time to take action immediately before loosing the tail. Side by side with strengthening the audit wing of VAT internally, and taking into account FIRA's work plan of spot audits and probably the conduct of VAT audits by or jointly with the LTO, as the practice of some countries suggests, it is recommended to outsource a certain volume of the audit function to either national or an internationally accredited tax audit company to help establish an effective audit selection system based on risk of revenue loss. For example, in Mexico, most information is coming from the ValuNet for goods imported through customs and from audit firms.

The South African Revenue Service has also contracted out the audit part of tax collection to a company called KPMG. Many Tax and Customs Administrations do the same thing in the areas which lack capability. Creating such kind of complementarities in the tax and customs administration and contracting out such activities to those who are capable of doing it due to their international presence and expertise could contribute a lot in improving the efficiency and effectiveness of the tax and customs administration and enhancing revenue collection.

5.6. Refunds Management

Even though, countries have the legal and administrative framework, the administration of VAT refunds is a persistent problem. The problem emanates from a widespread of abuse and fraud in filing credits and refunds by tax payers and exporters and also the reluctance of officials to give tax refunds.

These have contributed to delay of refunds to exporters, hence, stranded the competitive position of the exporters; and carrying forward of excess credits which erodes the value of capital-goods exemption. This might call for conducting too intensive checks before issuing a refund which might impair the financial capacity of exporters or conducting rapid check for all export refunds coupled with in-depth audits.

According to Article 27/1 of the VAT proclamation 285/2002, " if at least 25% of the value of a registered person's taxable transaction for the accounting period is taxed at zero rate, the Federal Inland Revenue Authority shall refund the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

Also, Article 27/2 stipulates that in 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. Up to now, except for the introduction of the voucher system for coffee exporters which actually helped to reduce their transaction cost, neither refund has been made to those who have filed credits nor did penalty imposed on fraudulent credit filers supported by audit findings. Also, the law kept silent on refunds to tourists/travelers who buy goods from the local market. This actually has a negative effect on the volume and value of purchases by tourists/travelers and the foreign exchange earning of the country. Different countries have stipulated in their respective laws that such kind of refunds are made at the airport departure terminals if the purchase is above a certain amount. Hence, after strengthening the administration of VAT and creating the necessary computer network infrastructure and introducing the electronic cash register system in the business sector, incorporating an article in the law on this kind of refund might contribute a lot to introduce Ethiopian products to the other world and to generate foreign exchange earning from tourists/travelers.

5.7.Penalties

Penalties for intentional and severe tax evasion and taxpayer non-compliance with the tax laws are a common tax administration practice in the world. Nonetheless, the types of penalties imposed for violation of VAT legislations differ from country to country. Some countries send violators directly to prison. Others temporarily close the taxpayers' business premises. Some levy stringent fines for failure to register and to file returns on time.

In the Ethiopian case, according to articles 45-47, administrative penalties are imposed while businesses are not registered for VAT where registration is required, where any person issued incorrect tax invoices, where invoices are issued without being registered, where there is underpayment and late filing of returns. Articles 48-59, however give emphasis to criminal offences. According to Article 48 of the proclamation, a tax offense is a violation of the criminal law of the country and is subject to criminal charge and prosecution. Tax evasion, making false and misleading statements, obstruction of tax administration, failure to notify changes in business address and business line, unauthorized VAT collection, improper tax debit and credit notes, aiding or abetting, offence by entities, offences by tax officers, offences by receivers are liable on conviction to monetary fine of Br1000-200,000 and imprisonment of not less than 1 year to not more than 15 years depending on the gravity of the offence. On top of these, the Authority is mandated to publish the list of persons who have been convicted of offenses, by notice in the Gazette.

While penalties for late filing have been applied by the VAT department, other penalties have not been implemented as stipulated in the law due to the Ministry's tolerant position at the commencement of the new system in view of the scope of the reform measures. However, as from the beginning the number of credit filers was on the increase, there was and still there is unauthorized collection of VAT, failure to use the prescribed invoices and other criminal violations. The Ministry and FIRA have successively advised the business community to comply with the law. The problems that the FIRA encountered with taxpayers who failed to do so has led to about 60 prosecutions. These types of actions are to be expected in any country which introduces the VAT.
In order for the penalty scheme to work effectively, the Ministry of Revenue should continue to look into the weak sides of Tax Audit, Intelligence and enforcement, and the legal wing of the FIRA and build their capacity through training, deployment of adequate staff and other resources. This would satisfy the interest of the government and genuine businessmen.

5.8. Cost of Administration

Professionals in the area estimate that the cost of administering VAT in most developing countries ranges between 1 and 2% of collection. Readers should well know that low collection costs may not reflect efficiency but rather indicate that important functions are either neglected or not well resourced.

The cost of VAT administration in Ethiopia includes: - the salaries, wages and top-ups to staff deployed to VAT department, the cost of fixed assets and consumables including telephones, faxes, internet, electricity and power, fuel and lubricants etc.... Since customs collects duties and taxes in a single administrative document, i.e. the customs declaration, it is very difficult to apportion the cost of administration for VAT. However, it is assumed that the percentage of VAT collection in total customs revenue is taken as a rate to calculate the VAT administration cost from the total customs salaries and wages budget. Due to data limitation and difficulty in the apportionment of budget, the salaries and wages for VAT department and braches which is about Br.1,003,848 and 41.5% of customs salaries and wages which is about Br 8,715,000 gives us a total of VAT administration cost of Br 9,718,848. The ratio of these expenditures to total VAT collection gives us a cost of Br 0.00186 to collect Br 1 of revenue which is by far below the international standards, and actually indicates under-resourcing and justifies as part of the reasons for Ethiopia's tax-GDP ratio to be the lowest in Sub-Saharan Africa.

Table 3:- Cost of Administration of VAT

	Addis Ababa-VAT Dept.	Nazareth	Awassa	Dire Dawa	Mekelle	Bahir-Dar	Jimma	Total
FIRA-Salaries and wages	882,672	15,732	30,012	17,340	14,280	24,480	19,332	1,003,848
Customs	-	-	-	-	-	-	-	8,715,000
Total								9,718,848
Total VAT collection								5,234,730,000
Administration cost								0.00186

Source: FIRA and Customs- Administration and Finance, Budget for 2003/2004 fiscal year.

6. VAT Rate, Base and Revenue Performance

6.1. VAT Rate

As stipulated in article 7 of the proclamation the standard VAT rate is 15%. The Turn over tax proclamation on the other hand imposes 10% on service and 2 % on goods for below-the-threshold transactions as equalization tax. This has to be reviewed as rate differentiation could raise administrative and compliance costs which could undermine the VAT revenue performance (Tait, 1988). According to Zeljko Bogetic and Fareed Hassan (1993), empirical results confirm that VAT generates, other things being constant, higher revenue in single VAT rate countries than in multiple rate countries. The message should be clear for policy makers, in order to generate superior revenues; a VAT should be levied in a single rate on as broad base as possible; it also must be accompanied by a strong tax administration to ensure enforcement and compliance.

6.2. VAT Base

As to Cnossen (1991), the tax base for VAT can be broadly classified into five categories:

a) All goods and services (G+S);
b) Goods and selected services (G+ST);
c) Goods only (G),
d) Consumer goods and capital goods (G+CG); or
e) Consumer goods, selected services and capital goods (G+ST+CG).

According to the VAT proclamation of Ethiopia, the tax base covers every taxable transaction by a registered person and every import of goods, other than all exempt import and ignoring zero rates and some exemption transactions on basic commodities. Hence, the tax base for Ethiopia seems to cover, to a certain extent, most goods and services. But, due to the misunderstanding of registrants and those who claim to be under the threshold try to erode the base for two reasons. First, the threshold is very high; second, the 2% turnover tax seems to be attractive to those above the threshold to underreport their annual transaction and tax return. The dispersion of 5% and 13% could contribute to the evasion and this may adversely affect VAT revenue, through the erosion and distorting of the base and distorting the market. This has already become a concern to genuine registered traders. The registered traders have reported that they will be obliged to subdivide their business to come out of the threshold. Hence, coupled with the unregistered businesses and the flocking to below the threshold, the tax base could be eroded, and tax collection would rest on few registrants only.

6.3. Revenue Performance

Revenue is collected at customs during importation and at the VAT department and branches of Federal Inland Revenue. Before we look into the general VAT collection it is important to see the revenue performance of each institution separately. As it was mentioned earlier the VAT has replaced the sales tax which was 15%. This rate, by itself, doesn't have any revenue implication at customs as the rate is the same as before, unless otherwise the volume and value of imports increases. During the first half of 2002/03, the Ethiopian Customs Authority has collected sales tax of Br.770.42 million the share of which was 41.8% of the total collection of the first half. After the VAT was introduced on January 1/2003, the collection of VAT for the second half of the same fiscal period increased by 2.6% to Br.790.39, the share of which in the second half collection was 42.39%. This increase in the VAT collection over the sales tax is justified by the variables such as the volume of imports, transaction value of imported goods, the duty and excise tax rates of the goods imported, the clearance time during importation and the like that determine revenue in customs. The annual sales tax and VAT collection had been Br.1, 560.83 with share of 42.1% in the total annual collection.

Table 4:-Ethiopian Customs Authority

2002/03 Revenue Performance

(In Million Birr)

	Duty/ Tax Type	2002							2003							Total Annual Collect
		July	Aug	Sept	Oct	Nov	Dec	Total 1st half	Jan	Feb	Mar	Apr	May	June	Total 2nd half	
1	Customs Duty	162.42	173.69	144.49	123.54	118.86	111.56	834.55	172.46	121.33	133.02	116.82	125.72	147.22	816.57	1,606.12
2	Excise Tax	13.79	24.85	15.85	14.58	30.91	11.65	111.63	19.11	21.90	29.21	32.58	58.40	53.99	215.19	326.82
3	Sales Tax/VAT *	152.59	151.65	138.65	122.26	106.52	98.75	770.42 41.8%	113.24	120.71	144.13	124.06	133.59	154.66	790.39	1,560.83 42.1%
4	Total Import Duties & Taxes	328.80	350.19	298.99	260.38	256.29	221.96	1,616.6	304.81	263.94	306.36	273.46	317.71	355.87	1822.15	3,493.77
5	Export Tax	24.07	20.07	11.56	0.38	2.25	0.40	58.73	11.16	0.50	0.21	0.27	0.08	0.12	13.06	71.07
6	Non-Tax Items	11.68	12.50	12.29	11.37	9.77	9.78	67.39	9.91	11.92	13.13	11.70	12.46	15.97	75.09	142.48
	Total Revenue	364.55	382.76	322.84	272.13	268.31	232.13	1,842.72	280.80	276.36	319.70	285.43	330.25	371.98	1864.52	3,707.32

Source: Plan & Research Department, MoR

As can be seen from the following table, during the nine months of the 2003/04 fiscal period, the collection of VAT has been Br.1, 742.85 billion with a share of 41.6% in the total collection of Br4, 200.43. Having the same rate with the previous sales tax the absolute increase in the VAT revenue could only be justified by the variables mentioned above.

Table 5:- Ethiopian Customs Authority
2003/04 Revenue Performance

(In Million Birr)

	Type of Duty & Tax	2003							2004				
		July	Aug	Sept	Oct	Nov	Dec	Total/ 1st half	Jan	Feb	Mar	April	Total 9 months Collection
1	Customs Duty	118.60	168.21	134.32	252.33	198.37	324.76	1,196.56	213.09	164.68	274.56	-	1,848.92/ 44%/
2	Excise Tax	34.16	39.65	31.51	74.59	41.13	71.03	292.07	51.48	42.36	55.90	-	441.81
3	VAT	118.65	160.35	141.79	275.31	204.04	268.91	1,169.05	202.71	150.69	220.40	-	1,742.85/ 41.5%/
4	Total Import Duties & Taxes	271.41	368.21	307.62	602.23	443.54	664.70	2,657.71	467.28	357.73	550.86	-	4033.58
5	Sur Tax	0.05	0.14	0.10	-	0.04	1.67	2.00	0.01	0.87	0.19	-	3.07
6	Non-Tax Rev.	9.98	13.17	11.89	19.89	21..71	23.58	100.20	19.98	20.44	23.16	-	163.78
	Total Collection	281.44	381.52	319.59	622.12	465.29	689.95	2,759.91	487.27	379.04	574.21	-	4,200.43

Source: Plan & Research Department, MoR

However, much is expected from Federal Inland Revenue Authority (FIRA) which is collecting VAT from transactions of distributors and wholesale of imports and local production and transactions up to the retail stage. The meaning of VAT to bolster revenue rests on the effectiveness and efficiency of the FIRA. The collection efficiency of FIRA is determined by the appropriate design of the implementation of VAT. As depicted in the following table, the collection of service and commodity sales tax during the first half of the 2002/03 fiscal period was Br.461.74 with a share of 27.5% during the period. However, after the introduction of VAT on Jan 1/2003, the collection of service and commodity turn over tax (TOT) and VAT has increased by 11.9% to Br.516.88, with a share of 42.2% in the second-half. In this period the collection of both sales tax, TOT and VAT has been Br. 978.62 million, with a share of 33.7% in FIRA's annual collection.

Table:-6 Federal Inland Revenue Authority

2002/03 Revenue Performance (In Million Birr)

	Type of Duty & Tax	2002							2003							Total Annual Collect
		July	Aug	Sept	Oct	Nov	Dec	Total / 1st half	Jan	Feb	Mar	Apr	May	June	Total 2nd half	
1	Direct Tax	67.28	187.16	117.45	536.75	51.61	60.04	1020.29	56.46	93.06	89.91	121.03	56.71	67.18	484.35	1,504.64
2	Indirect Tax	108.88	108.40	120.62	94.41	116.09	104.59	652.99	118.12	146.70	106.10	115.78	101.46	146.95	735.11	1,388.10
	2.1. Excise Tax	31.22	24.68	29.84	26.17	24.99	26.45	163.35	28.54	36.83	27.66	31.17	25.43	44.19	193.82	357.17
	2.2. Commodity T.O.T	-	-	-	-	-	-	-	-	19.74	10.18	1.51	1.51	0.67	33.61	33.61
	2.3. Service to T.O.T.	-	-	-	-	-	-	-	-	9.16	5.91	3.59	2.93	3.20	24.79	24.79
	2.4. Commodity Sales/VAT	46.53	45.30	53.83	39.97	54.36	43.30	283.29	37.71	51.42	49.31	58.52	48.97	71.78	317.71	601.00
	2.5. Service Sales Tax/VAT	26.09	32.84	32.83	23.94	31.99	30.76	178.45	48.51	25.08	8.97	17.74	18.18	22.29	140.77	319.22 **978.62**
	2.6. Stamp Sales & Tax	5.04	5.58	4.12	4.33	4.75	4.08	27.09	3.36	4.47	4.07	3.25	4.44	4.82	24.41	51.50
3	Total Tax Collection	176.16	295.56	238.07	631.16	167.70	164.63	1673.28	174.58	239.76	196.01	236.81	158.17	214.13	1219.46	2892.74

4	Non-Tax Revenue	1.31	0.84	0.65	1.15	1.01	1.37	6.33	1.04	0.77	1.80	0.88	0.24	0.40	5.13	11.46
	Total Revenue	177.47	296.40	238.72	632.31	168.71	166.00	1679.61	175.62	240.53	197.81	237.69	158.41	214.53	1224.59	2904.20

Source: Plan & Research Department, MoR

During the first-half of the 2003/04 fiscal period, however, the collection of service and commodity TOT and VAT has reached the tune of Br. 597.33 with a share of 32.8% and is greater than the sales tax of same period in 2002/03, and Br. 952.45 million for the nine-months period with a share of 39.1%. Definitely, there is an increase in the collection of VAT compared to the sales tax. However, this should be seen together with the number of registrants, the efficiency of auditing and enforcement in FIRA.

Table 7:-Federal Inland Revenue Authority
2003/04 Revenue Performance

(In Million Birr)

	Type of Duty & Tax	**2003**						**2004**				
		July	**Aug**	**Sept**	**Oct**	**Nov**	**Dec**	**Total/ 1st half**	**Jan**	**Feb**	**Mar**	**Total 9 months**
1	**Direct Tax**	**58.17**	**83.53**	**341.85**	**372.24**	**73.49**	**75.56**	**1,004.84**	**76.62**	**70.54**	**74.82**	**1,159.82**
2	**Domestic Manufactured goods excise tax**	**29.89**	**31.93**	**29.14**	**45.78**	**23.42**	**31.20**	**191.36**	**28.01**	**35.79**	**41.67**	**280.60**
3	**Commodity T.O.T**	**0.70**	**1.03**	**1.12**	**2.80**	**1.75**	**4.47**	**11.87**	**4.50**	**13.23**	**0.98**	**29.84**
4	**Service to O.T.**	**10.08**	**3.76**	**3.30**	**16.62**	**4.90**	**11.73**	**50.39**	**2.00**	**3.17**	**7.78**	**59.00**
5	**Commodity VAT**	**73.37**	**66.04**	**62.56**	**66.07**	**67.90**	**51.69**	**387.63**	**63.79**	**85.99**	**121.27**	**664.74**
6	**Service VAT**	**26.46**	**23.82**	**20.11**	**23.33**	**27.34**	**26.38**	**147.44**	**24.35**	**25.68**	**0.85**	**198.78**
7	**Total Commo-dity & Service VAT**	**110.61**	**94.65**	**87.09**	**108.82**	**101.89**	**94.27**	**597.33**	**94.64**	**128.07**	**130.88**	**952.45**
8	**Stamp Sales & Tax**	**3.50**	**5.69**	**4.83**	**2.79**	**5.81**	**3.96**	**26.58**	**4.19**	**5.85**	**9.98**	**39.35**

9	**Non-Tax Revenue**	**0.25**	**0.24**	**0.05**	**0.08**	**0.07**	**0.12**	**0.81**	**0.10**	**0.08**	**0.20**	**1.03**
	Total Revenue	**202.42**	**216.04**	**462.96**	**529.71**	**204.68**	**205.11**	**1,820.92**	**203.56**	**240.06**	**257.46**	**2,433.25**

Source: Plan & Research Department, MoR

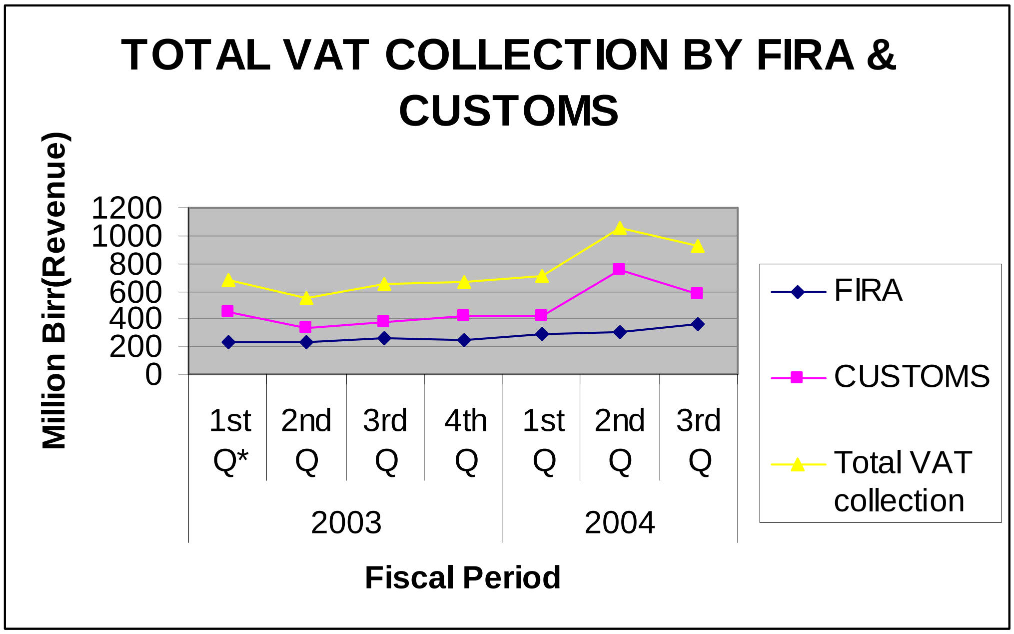
The following table shows that compared to sales tax collection, the trend in VAT collection is on the increase. While the increase in customs collection is explained by the variables mentioned above, the increasing trend in FIRA should be further investigated. As mentioned above, FIRAs collection has to be seen together with the tax base, the single rate and the administrative capacity of the VAT department and its branches. The largest share of VAT collection almost close to 65% comes from Customs while the remaining comes from FIRA. However, collection by FIRA has to increase since VAT is a consumption tax up to the retail stage in the country by strongly enforcing the law. In general, however, the increase in the yield of VAT in the past five quarters shows the buoyancy of the tax.

Table:-8 VAT Collection from Jan/2003 - March/2004
By FIRA & Customs Authority

(In Million Birr)

	2003				2004			Total Sales/ VAT	Total 9 months 2003/04
	1st Q*	2nd Q*	3rd Q	4th Q	1st Q	2nd Q	3rd Q		
FIRA	237.42	224.32	265.99	250.89	292.35	304.98	355.12	1931.07 (36.8%)	952.45 (35.3%)
CUSTOMS	442.89	327.53	378.08	412.31	420.79	748.26	573.80	3303.66 (63.2%)	1742.85 (64.7%)
Total Sales/VAT	680.31	551.85	644.07	663.20	713.14	1053.24	928.92	5234.73	2695.30

*First and Second Quarters are for sales tax while the rest are for equalization tax (TOT) and VAT



When we see the revenue collected from the registrants in table 2 above, the marginal increase of revenue as the number of registrants increase is insignificant. The reason to this is, despite an increase in the number of registrants, the number of VAT return filers has been declining with an increase in credit filers, nil-filers and non-filers. For example, in Addis Ababa, VAT return filing has been declining from 100% in October/2003 to 69.8% in March/2004. Out of the 100% return filers in October/2003, however, those who happen to pay VAT were 31.8% while the 68.2% were credit filers, nil-filers and non-filers. In March/2004, 21.9% have paid the tax while 78.1% haven't. When we see the general trend of compliance during the nine months of the 2003/04 fiscal period, it was around 28%. According to a report to the trading community by the VAT department; at the end of Dec/2003 the composition of registrants was 29.5% Plcs, 65% Sole Proprietors, 2.3% SoEs, 2.2% Private Share Companies and 1% Joint Ventures and their contribution to VAT revenue was 24%, 6%,49%, 20% and 1% respectively. This shows that 2.3% of SOEs contribute to the 49% of the revenue and 97.7% of the registrants from the private sector contribute to the 51% of the revenue (Getachew Eshete, Dec/2002).

Therefore, one can easily understand that the tax base is highly eroded for three basic reasons. First, those whose turnover is above Br 500,000 haven't fully registered and filed. Second, those who have registered are not complying. Third, businesses are flocking to attend the-below-threshold group. Hence, needs the attention of the tax administration.

When we see the extent of revenue by collection centers from table 9 below, 72.6% and 18% is generated from Addis Ababa and Nazareth respectively; while 9.4% is collected from the rest of the collection centers. In order to increase the number of collection centers FIRA has to open branches in Harar, Semera/Assaita, Gondar, Dessie and other cities where businesses above the threshold could exist. If opening offices is not feasible, either regional Finance and Revenue Bureaus or banks could be delegated. Many countries use the network of banks on commission to collect taxes. As the network of banks in the majority of the cases follows business transactions, taxation should follow the same path.

Table:-9 VAT Collection by collection centers

(in million Birr)

No	Branches	Feb 2003	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec 2003	Jan-Mar 2004	% share
1	A.A VAT Dept	59.69	40.41	51.54	50.22	60.30	74.53	64.76	56.94	62.25	66.91	63.63	240.34 891.52	72.6
2	Nazareth	16.76	13.90	19.38	12.47	16.13	16.81	20.57	15.58	19.81	12.85	8.25	52.25 220.56	18
3	Awassa	0.02	0.54	0.26	0.18	0.77	0.33	0.48	0.18	0.67	0.11	0.54	0.99	
4	Dire Dawa	0.03	2.66	3.27	2.65	3.53	1.45	2.81	3.26	4.15	2.70	2.63	9.39	
5	Bahir-Dar	-	0.77	1.81	1.63	1.97	1.82	0.97	1.49	1.84	4.67	2.35	6.08	
6	Mekelle	-	-	-	-	11.22	4.14	3.92	5.14	0.57	7.91	0.53	12.6	
7	Jimma	-	-	-	-	0.15	0.19	0.11	0.08	0.11	0.09	0.14	0.55	
8	Total VAT by FIRA	76.50	58.28	76.26	67.15	94.07	98.83	89.86	82.67	89.4	95.24	78.07	322.2 1228.53	100

Source: FIRA, Customs and MOR Plan & Research Department

In the Ethiopian case, as can be seen from the following table, the import/GDP ratio has been rising continuously from 20.8% to 35.6%. This in fact indicates that VAT collection at Customs would be simple.

According to Victoria Summers etal (2002), the "efficiency ratio"-the ratio of VAT revenue to GDP, divided by the standard VAT rate is the traditional measure of effectiveness of the VAT in raising revenue. However, due to flaws in the measurement, the "C-efficiency ratio"- the ratio of VAT revenue to consumption divided by the standard tax rate could be more appropriate as it focuses on consumption which is the ideal tax base. The C-efficiency ratios for small countries with VATs were strikingly high, averaging 65%, about the same as for the European Union countries. As calculated below, the C-efficiency ratio for the fifteen months old Ethiopian VAT collection, however, has reached 39.3%.Which means that VAT has been paid on the 39.3% of the consumption in the country, while 60.7% of the consumption has not been captured still.

Table10: Import/ GDP Ratio and C-efficiency Ratio

		1997/98 (1990)	**1998/99 (1991)**	**1999/2002 (1992)**	**2000/2001 (1993)**	**2001/2002 (1994)**	**2002/2003 (1995)**	**2003/04 (1996) 9 months**
1	**Import (in Millions)**	**9338.0**	**11702.0**	**13,115.8**	**12,967.7**	**14,485.3**	**14,961.6**	**15372.8**
2	**GDP at Current Market Price**	**44,840.3**	**48,803.3**	**53189.8**	**54210.7**	**51,760.71**	**54,585.9**	**43191.09***
3	**Import /GDP ratio**	**20.8%**	**24%**	**24.7%**	**23.9%**	**28%**	**27.4%**	**35.6%**
4	**Consumption**	**41,378.1**	**48,107.4**	**52,594.9**	**52.481.2**	**50,851.3**	**55,677.62**	**45725.24***
5	**Sales Tax /VAT**	**1342.26 (2.99**	**1436.19 (2.94%**	**1574.23 (2.9%)**	**1915.57 (3.53%)**	**2270.62 (4.38%**	**2,539.43 (4.65%**	**2695.30 (6.24%)**

		%)	)			)	)	
6	**Efficiency Ratio**	**0.25**	**0.245**	**0.247**	**0.294**	**0.365**	**0.31**	**41.6**
7	**C-efficiency Ratio**	**0.27**	**0.248**	**0.249**	**0.243**	**0.298**	**0.30**	**39.3**
8	**National Tax revenue**	**5,268.7**	**5,591.6**	**6,782.0**	**7,440.0**	**7926.0**	**8243.0**	**6868.87**
9	**National Tax Revenue as % of GDP**	**11.7**	**11.5**	**12.8**	**13.7**	**15.3**	**15.1**	**15.9%**
10	**Federal Tax revenue**	**4,257.7**	**4,780.3**	**5,387.5**	**6,273.8**	**6,517.0**	**6,716.4**	**6,633.7**
11	**Federal Tax revenue as % of GDP**	**9.5%**	**9.79%**	**10.13%**	**11.57%**	**12.59%**	**11.87%**	**15.4%**

Source: - FIRA, Customs, NBE Bulletin 2002/03, Ministry of Revenue
***Estimates/projection with growth rate of 5.5% for GDP and 9.5% for consumption**

The significant increase of the C-efficiency ratio in 1996 compared to 1995 shows that the VAT is buoyant with growth in the tax base, this in this case is the total consumption. But, much has to be done to reach a higher "C-efficiency" ratio through capturing those who are unregistered and taking measures on those who are not compliant up to now. Had it not been for this, both VAT revenue and the C-efficiency ratio would have been higher than the current one.

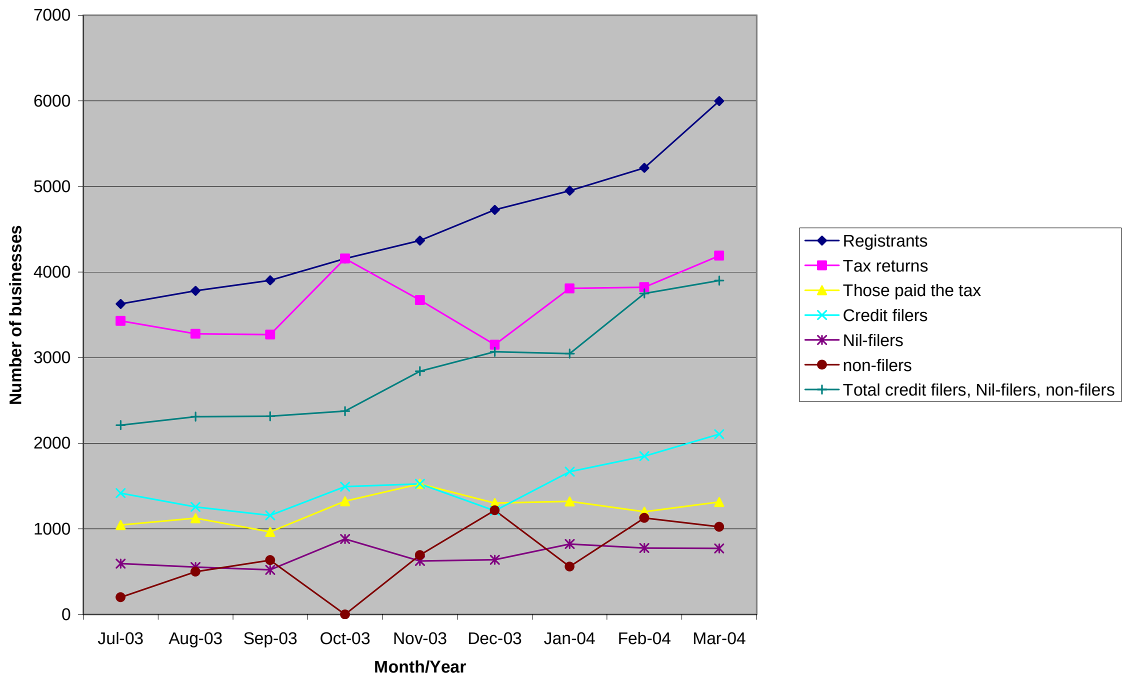
I. Tax Payers Compliance

Tax payers Compliance, in this case, is related to the fulfillment of the registration requirement, timely filing of VAT return and payment, and staying aloof of criminal offences such as tax evasion, making false statements, obstruction of administration failure to notify, unauthorized VAT collection, Aiding or abetting, improper tax debit and tax credit notes and the like. Hence, our measurement of tax compliance considers the above issues.

Despite the tax authorities' effort through seminars, workshop, and the media, up to now, those who should be registered and required to be registered due to the Br 500, 000 thresholds have not been fully registered. Those who are registered have been found wrongly dealing with buyers to reduce the price for not asking VAT receipt, and increase the price if asking for VAT receipt.

Others have made false and misleading statements regarding their stocks and filings, and producing improper tax debits and credits to the VAT department. Some have been found collecting VAT using unauthorized VAT invoices creating their own VAT numbers. As stated above, the number of VAT return filers has been declining with an increase in credit filers, nil-filers and non-filers. For example, as depicted in the graph below, in Addis Ababa, VAT return filing has been declining from 100% in October/2003 to 69.8% in March/2004. Out of the 100% return filers in October/2003, however, those who happen to pay VAT were 31.8% while the 68.2% were credit filers, nil-filers and non-filers. In March/2004, 21.9% have paid the tax while 78.1% haven't. When we see the general trend of compliance during the nine months of the 2003/04 fiscal period, it was around 28%.

Addis Ababa-Value Added Tax Compliance Status



The Federal Inland Revenue in collaboration with the Ministry of Justice is in the process to persecute those who offend the law. Tax payer's compliance problems are continuously manifested due to deliberate evasion and unlawfulness, and weak audit and enforcement capability of the tax administration.

VIII. Conclusion and Policy Recommendations

8.1. Conclusion

Ethiopia is a country where the tax revenue is less than 16% of the GDP. The tax revenue which was Br 5.4 billion in 1996/97 has increased to Br 8.2 billion in 2002/03. This has contributed to the growth of the tax revenue as a % of GDP to 15.1 in 2002/03 from 12.9% in 1996/97. This, nonetheless, shows that despite the increase in the tax revenue, Ethiopia's tax/GDP ratio is still low compared to other African countries which in most cases their tax yield is over 23% of the GDP.

As the country has faced with the challenges of the domestic business environment, regional integration and globalization which demands foreign trade taxes to decrease, and coupled with its commitments to the Bretton Woods institutions, the Government has reduced the maximum import duty from 230% to 35% and the weighted average tariff rate from 41.6% to 17.5%. It has also eliminated taxes on exports. The new Income tax and excise tax proclamation has also reduced income tax and excise tax. This actually affects its revenue. Hence, as Value Added Tax (VAT) has become a major tax instrument both in the industrialized countries and the developing and least developed countries, the Government had to introduce the VAT in order to broaden the tax base and to compensate for revenue loss as a result of duty reduction at customs, to reduce distortions by other indirect taxes and to compensate revenue losses due to trade liberalization.
The Government of Ethiopia, through its Tax Reform Program by the Ministry of Revenue in the revenue collection Institutions has been successful in the introduction and implementation of the

VAT. Despite the setbacks articulated in this paper, the reform on sales tax has registered an increase in revenue of VAT collected by FIRA and Customs.

To follow suit the international practice of taxation is important and beneficial to the country. However, still there are areas that have to be dealt with seriously and cautiously. Problems of registration for VAT, problems of issuing invoices and keeping accounting records, problems of fraudulent filing of credits and refunds, problems of understaffing and weak auditing, intelligence and enforcement and legal departments, problems in the implementation of penalties etc... have to be looked upon and remedial measures have to be taken as immediately as possible. The Public at large and the Government have to reach to a consensus to have a common national vision of development and work together to increase the tax yield of the country which finally is to finance social and economic development and poverty reducing projects by introducing a new tax culture
(Birger Nerre, 2001) which actually demands compliance from the side of all tax payers; and organizational strength and efficiency from the side of the tax administration.

8.2. Administrative and Policy Recommendations

The following are the recommendations that emanate from the above assessment.

1. Organizational strength is an important tool to effectively perform what has to be performed by a standard VAT office. Hence, the organizational setups of the VAT office and branches have to be revisited to effectively and efficiently perform the tasks of identification of VAT taxpayers, processing of returns, controlling collections, making refunds, auditing taxpayers, and levying penalties. The collection network should also consider following the banking network and use the banks as collection points.

2. The quality and quantity of human resource to be deployed should also be a concern to the administration when the activities to be conducted are not so simple. Training and development for staffs who will join and who have already joined should also be taken care of.

3. The tax base of Ethiopian VAT system covers most of the goods and services transaction with the threshold of over Br 500,000. All liable businesses in all sectors of the economy that fall within the threshold should be identified and get registered to broaden the tax base. The current collection is hanged on few compliant registrants.

4. The execution of the provision of TIN has to be accelerated to improve the effectiveness of the tax administration. All tax payers have to get their TIN from FIRA system in the shortest time possible. To this end, aggressive tax-payers education and deployment of adequate data entry clerks should not be overlooked.

5. As to the requirement of the Commercial code of 1960 and the subsequent tax laws, any person or business organization should keep books and accounts and issue legal invoices approved by FIRA. The FIRA should also collaborate with other institutions to follow up and take appropriate measures on those who do not comply with the laws.

6. The SIGTAS has to be utilized to the maximum possible to control tax filing and payment. Those credit filers, nil filers, non-filers and stop-filers have to be identified and audited frequently and appropriate measures taken.

7. The organization and staffing of tax audit has to be revisited. The manual auditing has to be assisted by a computerized system. Adequate professional staffs have to be deployed. Audit functions should not be subject to delay. A certain portion of the audit

function has to be contracted out to ethically and professionally recognized national or international audit firms.

8. In order not to hinder the competitive position of coffee exporters the voucher system has accommodated the problem on refunds. The rest, however, have to be treated as stipulated in the law. After sufficient infrastructure is arranged, banks at the departure terminal of our international airports should be delegated to administer refunds to departing passenger who can produce genuine VAT invoices for goods purchased locally. The price threshold should be set in advance.

9. Penalties have to be enforced according to the law. The Special Courts set up by the Government have to accelerate giving verdicts to prosecutions.

10. The cost of administering the VAT is very low. Considering the 28% compliance level, this doesn't indicate efficiency, rather it indicates that the administration of this tax is devoid of resources, as a result of which the tax would not be collected effectively and efficiently. Hence, as is the case with other countries the tax administration should retain 1% to 2% of its collection to finance the administration of the tax.

11. As empirical research has proved, high revenue of VAT is generated in single rate countries than multiple rate countries as the administrative burden and compliance costs would not undermine the VAT revenue performance. Though, Ethiopia has introduced a single rate VAT, the problem of the dispersion of 5% and 13% between the standard VAT rate and the rates of equalization tax (TOT) for services and goods has to be cautiously seen.

12. Revenue performance has improved over the sales tax. But, the revenue performance at customs is not because of the introduction of the VAT, but due to other variables stated in the paper. Other things being equal, no doubt with the increase in volume and value of imports and improvement in clearance time, the revenue will increase at customs and an importer have no way to escape from paying the VAT. But, with FIRA, even though, we have seen improvement in the collection, it has to make more efforts in identifying and registering of taxpayers; processing returns; following and taking actions on non-filers, nil filers and stop-filers; strengthening its audit and enforcement and broadening its tax base.

Annex 1:- Government Revenue and Grants, Government Expenditure and Budgetary Deficit (1993/94-2002/03)

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
GDP at Current Market Prices	28328.9	33885.0	37937.6	41465.1	44840.3	48803.30	53189.80	54210.70	51760.71	54585.90
Tax Revenue	3076.5	3878.7	4723.3	5358.2	5261.1	5591.6	6482.8	7440	7928	8243
Income and Profit taxes	899.6	1230.8	1648.8	1745.3	1649.5	1833.5	2169	2495	2980	2878
Domestic Indirect Taxes	834.1	945.5	1155.6	1289.9	1180.6	1204.3	1440	1382	1499	1668
Foreign Trade taxes	1297.2	1621.5	1813.9	2163.6	2218.4	2378.5	2675.8	3233	3308	3565
Non Tax revenue	862.4	2034.2	2242.9	2519.3	3139.1	3861.6	3665.1	2737	2482	2907
Total Revenue	3938.9	5912.9	6966.2	7877.5	8400.2	9453.2	10147.9	10177	10410	11150
External Grants	987.2	1131.7	1096.7	1504	1273.3	1762.1	1724.1	2628	2425	2446
Total Revenue and grants	4926.1	7044.6	8062.9	9381.5	9673.5	11215.3	11872	12805	12835	13596
Total Current Expenditure	4399.3	5215.4	5582.2	5717.4	7094.9	10126.5	13739.2	10380	10551	12305
Total capital expenditure	2694.4	3156.4	3705.4	4299.8	4265.1	4430.2	3441.9	5003	6130.3	5818
Total Expenditure	7093.7	8371.8	10336.8	10017.2	11460	14556.7	17181.1	15383	17652.3	18402
Overall budget deficit including grants	-2167.6	-1327.2	-2273.9	-635.7	-1642	-3341.5	-5961.6	-2981.4	-4814	-4766
Overall budget deficit excluding grants	-3154.8	-2458.9	-3370.6	-2139.8	-2915.3	-5103.6	-7985.6	-5609.4	-7242	-7913
External Debt(disbursed)	25722.2	27731.5	27088	26509.61	27916.88	31566	44647.5	46268.8	52994.25	58591.82

Source: National Bank of Ethiopia, Annual Reports: 2000/01,2001/02,2002/03

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