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**The Challenges of Tax Incentives on Government Revenue:
The Case of ERCA**

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THE CHALLENGES OF TAX INCENTIVE ON GOVERNMENT

CUSTOMS AUTHORITY

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Acronyms

ASYCUDA	Automated System for Customs Data Administration
DBE	Development Bank of Ethiopia
EFY	Ethiopian Fiscal Year
EIA	Ethiopian Investment Agency
ERCA	Ethiopian Revenue and Customs Authority
FDI	Foreign Direct Investment
FIRA	Federal Inland Revenues Authority
GDP	Gross Domestic Product
IA	Initial Allowance
ICA	Initial Capital Allowances
ITC	Initial Tax Credits
MoFEC	Ministry of Finance and Economic Cooperation
MNEs	Multi-National Enterprise
WTO	World Trade Organization

Abstract

The purpose of this study is to investigate “The challenges of tax incentives on government revenues: the case of ERCA”. The study employed a descriptive research method and used both qualitative and quantitative research approaches. The primary and secondary data were gathered and used for this research. The data collected through different tools were analyzed and interpreted by using descriptive statistics tools. The finding of this study shows that the investment related tax has a significant negative effect on government revenue. This study also revealed different challenges in the administration of the investment incentives in ERCA. The legal framework is found as complex, inconsistent, unstable, and insufficient and lack coordination with administrative procedures. Similarly, administrative under capacity, non-coordination between ERCA and different organs, interventions from both internal and external bodies and lack of attention are identified as the major challenges. It is also found that incentives are prone to abuse and the authority does not have strong mechanisms of monitoring and controlling. The researcher recommended that ERCA should have a mechanism to measure the cost and benefit of tax incentives on timely manner. The tax expenditure amount should be reported timely with other reports to the concerning body to create transparent and accountable tax system. Finally, the study suggested some probable solutions including keeping the tax incentive system simple, strengthen administrative capacity, strengthening continuous audit system, improving enforcement capacity and imposing economically meaningful penalties in the case of abuse.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Many developing nations face pressure to sweeten their tax incentive programs to compete with tax breaks offered in other parts of the world (Klemm, 2009). Ethiopia offers tax incentives and is also under great pressure to strengthen the domestic revenue systems in order to generate adequate and sustainable funding for essential public goods and services.

In response to these influences, Ethiopia has implemented Economic Reform Program (ERP) since 1992/93 with the support of World Bank, International Monetary Fund, foreign governments and other multilateral institutions. The tax reform has got momentum in 1999 when the “Revenue Board” scaled up to the level of Ministry named as “Ministry of Revenue” and the reform expanded from tax policy measures to administrative reform.

The reform measures are intended to encourage trade, investment and hence development; broadening the tax base and increase Government revenues to support social programs and alleviate poverty; strengthen the enforcement capacity of the tax and customs authorities; and promoting equity in the tax system.

On the other hand the country has formulated its first investment proclamation in 1992 (proclamation no. 15/1992). Since then, amendments were made in accordance with the situation. The investment proclamations formulated from time to time have taken tremendous measures that helped to create accumulation of resources by both the foreign and local investors. Although tax incentives definitely affect investment decisions in some circumstances, it is not at all clear that the overall benefits balance the costs. Despite the controversy, Ethiopia offers investment tax incentives of one form or another to compete with tax breaks offered elsewhere. Some of the measures include; customs tax relief, exemption of income tax on some selected sectors like manufacturing, agro-processing, agricultural development, hotel and tourism and information communication. In addition to this; for investor’s in the export sector; tax refund, Voucher scheme and bonded manufacturing warehouse privileges are also given (Ethiopian investment guide, 2012).

The major reason as indicated above is that to attract foreign direct investment and encourage the private sector participation in the economy; both from domestic and abroad; which will help to increase employment, bring technological transfer, enhance the local management skill, bring knowledge transfer, increase the domestic capital saving, raise the level of foreign reserve and finally, these will contribute to the economic development of the country (Simret Mamuye, 2013).

All the above indicated efforts show that the efforts made by the government are to create conducive environment to the private sector to contribute its share in the economy. To do this; the incentive given by the government is increasing the misuse of duty free incentives (Fraud) and highly eroding ERCA's annual revenue collection from year to year (ERCA, 2016 Report).

Even though the government is making paramount efforts to help internal and external investors, the researcher observed the misbehaving activities on the side of some local and foreign investors like misuse of the privileges, tax evasion, hiding information, and misinformation to the authority, non-performance of their responsibilities and poor performance as well as poor follow-up and management activities by the authority is increasing from year to year and has created the major problem in the tax administration specially on tax incentives. Due to this; assessing the current challenges & impact of tax incentives on government revenue is necessary.

1.2 Statement of the Problem

The research conducted by ISODEC (2014) describes that the capacity of many developing countries to raise the needed tax revenue to finance their development can easily be constrained by over-generous tax incentive regimes whose benefits have not been critically evaluated. These helps up to doubt the benefits of tax incentives and critically evaluate it. In the same way; Wulf and Sokol (2005) indicated that many developing countries have difficulty of properly administering and monitoring duty relief regimes and exemption regimes. This has resulted in abuse, fraud and revenue leakage. This works will help us to think over that ways and capacity to build in order to ensure the intended purpose of incentives.

As a result; incentives require governments to administer them and curb their misuse (James 2010). Unless they are properly administered, they can impose additional costs on business and create opportunities for rent seeking. Hence, there should be policies to mitigate such problems. If the government does not improve the administration of incentives granted, they may collect

unintended outcomes. James (2009) also proposed the ways to reduce such undue costs. He suggests that effective policies of incentives reduce non-revenue costs by using ways like reducing the misuse of incentives, administering incentives effectively and easing the compliance burden on investors who want to take advantage of incentives.

Even though investment incentives are arguably important for investment attraction, it has different problems for tax administration authorities in particular and other concerning government institutions in general and business communities. One of the challenges of investment incentives is their difficulty to manage. Because, they require a complex administrative task, so that would be more effective than the purpose of covering the costs of their implementation and to produce net benefits (Cristina and Marcel, 2012). One reason for its difficulty for administration may be the difficulty to monitor the firm's operation to ensure the firm does not engage in additional non-qualifying activities. Even where the activities are separated, it is very difficult to monitor related party transactions to make sure that income is not shifted from a taxable firm to a related firm that qualifies for incentives (Easson and Zolt, 2002).

Similar to many countries in the world, to encourage private investment and promote the inflow of foreign capital and technology into Ethiopia, the government of Ethiopia provide both fiscal and non-fiscal incentives for both domestic and foreign investors engaged in eligible new enterprises or expansion projects such as agriculture, manufacturing, agro-industries and construction contracting etc. (Ethiopian investment guide, 2012).

However, the researcher has observed while he was an employee of ERCA; some beneficiaries of the incentives are not using it for the intended purpose. This means, considerable numbers of investigation files at head office crime investigation directorate and Addis Ababa Kality Customs Branch office annual report (2006-2015) shows that there exists the misuse of incentives for unintended purpose. Thus, this is the indicator of lack of systematic monitoring and evaluation of the extent to which they are working and they are achieving the intended purpose. Unless, granting and implementation of incentives is properly administered, it can adversely affect the business community; government and the public at large, and the government losses huge amount of public revenue, in expectation of higher revenue and other social benefits from increased investment.

If fiscal incentives are properly designed and administered and are ultimately able to achieve the ends for which they were intended, then those foregone revenues would have been compensated by the expanded tax base that those investments have created. Thus, in the absence of proper administration, it may create additional problem. Ndunguru (2012) identifies assessing their effectiveness; controlling ‘ exemption creep’ pressure from lobby powers; Agreeing on the proper incentives recipe-balancing economic versus political interest; Combating the race to the bottom effects of incentives; Putting in place effective administrative monitoring machineries, Achieving simplicity in the tax system; Building data base for informed analysis and Ensuring predictability of tax revenues as the major challenges of tax incentives and exemption for tax policy and revenue administration.

However, as to the best knowledge of the researcher, it’s hard to find practical researches on the challenges of tax incentives on government revenue. Therefore, to assess all these problems & challenges and contribute valuable input to the proper administration of investment incentives to benefit from its outcomes, the researcher is motivated to conduct this research.

Research Questions

This research is conducted to answer the following basic questions regarding to the challenges and impact of tax incentives on the government revenue in the case of ERCA:

- ✚ What are the factors affecting the administrative capacity of tax incentives?
- ✚ How much is the revenue forgone by government as a result of the tax incentives granted for investors?
- ✚ What are the effects of the legal and administrative frameworks in the administration of investment incentives?
- ✚ What are the techniques in which beneficiaries abuse their investment incentive privileges?
- ✚ What are the basic appropriate mechanisms to improve proper implementation of the incentives?

1.3 Objectives of the Study

1.3.1 General Objective

The general objective of this study was to assess the challenges of tax incentives on the government revenue: in the case of Ethiopian Revenue and Customs Authority.

1.3.2 Specific Objectives

The specific objectives of this study are:

- ✚ To identify the factors affecting the administrative capacity of tax incentives.
- ✚ To assess the revenue forgone by government as a result of the tax incentives granted for investors
- ✚ To examine the effects of the legal framework and administrative procedures in the administration of investment incentives.
- ✚ To identify the techniques in which beneficiaries abuse their investment incentive privileges
- ✚ To examine appropriate mechanisms to improve proper implementation of the incentives.

1.4 Significance of the Study

To be effective in administering tax incentives, identifying appropriate administration mechanisms and transparent policy is very important. To this effect, as a developing nation that is in need of huge public expenditure to full fill the budget demand, understanding the impact of investment related tax incentives on government revenue is very important. Tax incentives need proper administration and both the costs and their benefits need to be clearly identified and known. So, the study is significant in filling the knowledge gap that has been observed in the area.

The study will also provide policymakers with a framework for analyzing the efficiency of investment incentives based on the sector and level of development involved and suggests reforms for moving toward with best practices.

Finally, the outcome of this study can provide an opportunity for further study related to administrative challenges of non-Tax incentives, stakeholder's role in the administration of investment incentives and the role of investment incentives in Ethiopia.

1.5 Scope of the Study

The study is mainly limited to Ethiopian Revenue and Customs Authority. Thus, it was convenient to obtain relevant documents and make appropriate discussions with concerned bodies in a timely manner. The study is, therefore, limited to the areas stated in the objective section of this paper.

1.6 Justification for the Study

Some of the courses were very interesting to the researcher because they helped him to look into himself and allowed to grasp some important knowledge, skills and attitudes on how tax incentives should be granted and managed efficiently and effectively to enhance domestic and foreign investment and fulfill the budgetary requirement of the government.

In addition, as an employee of ERCA, the researcher had time to observe the activities of tax incentives administration and stress on the challenges and impacts of incentives on government revenue and its contribution to the general economy. Although some studies reveal some empirical results on the historical development, causes, manifestations, types and benefits of tax incentives, yet identifying & solving the challenges and problems of the administration of tax incentives to maximize the benefits is very important.

Currently, ERCA is the major contributor of country's budget and its revenue collection is improving from time to time; on the other hand, huge amount of revenue is granted as tax incentives. The researcher believes that not only neglecting the issues of the challenges and impacts of tax incentives on government revenue collection but also failing to address boldly the adverse effects on the organization itself and the country as a whole. This is the motive for selecting the title as the focus area for the study.

1.7 Limitations of the Study

Lack of accurate data, non-cooperation of some leaders and officials were some of the problems. Another serious problem was non-cooperation to provide secondary data including reports in the name of keeping corporate confidentiality. However, there should be the limit to corporate confidentiality. It's not logical to hide every activity. Activities to be kept confidentially should be stated expressly or known from their nature of importance.

Notwithstanding the limitations, the researcher took different measures to reduce the effect of limitations on the thesis. In order to reduce the non-cooperation of officials; the researcher try to clarify the importance of the research and promise for the confidentiality of the data. Though it was very challenging to find relevant secondary data, some previously collected data by another researcher which is relevant for the study was used. Moreover, secondary data were collected from different fragmented sources.

1.8. Organization of the Study

The study is organized in to five chapters. Chapter one contains introduction, statement of problem, objective, significance, scope and limitation of the study. The second chapter covers the theoretical and empirical reviews of literatures related to tax incentives. Chapter three focuses on research design and methodology of the study. Chapter four deal with findings of the study and the last chapter present summary of the findings, conclusions, and recommendation.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In this part reviews the relevant theoretical and empirical literature with understanding of concepts related with the challenges of tax incentives on government revenue so as to identify gaps.

2.2 Theoretical Literature

2.2.1 Definitions and Concepts of Tax Incentives

A tax incentive can be defined either in statutory or in effective terms. In statutory terms, it would be a special tax provision granted to qualified investment projects (however determined) that represents a statutorily favorable deviation from a corresponding provision applicable to investment projects in general i.e., projects that receive no special tax provision.

In effective terms, a tax incentive would be a special tax provision granted to qualified investment projects that has the effect of lowering the effective tax burden measured in some way on those projects, relative to the effective tax burden that would be borne by the investors in the absence of the special tax provision under this definition, all tax incentives are, therefore, necessarily effective (Zee et al. 2002).

Investment incentives are; ‘The grant of a specific advantage arising from public expenditure [a financial contribution] in connection with the establishment, acquisition, expansion, management, operation, or conduct of an investment of a Contracting Party or a non-contracting Party in its territory (UNCTAD, 2004).

According to James (2009), Tax incentives are popular with governments for a variety of reasons, including:

- ❖ They are a less visible way for governments to provide special benefits to certain businesses.
- ❖ They are easier to provide than infrastructure, labor skills, or other investment climate improvements.

- ❖ When ministries other than the ministry of finance are allowed to provide tax incentives, the incentives are misaligned. Other ministries tend to give more incentives than is optimal because they do not have to bear the burden of lower tax collections.
- ❖ Governments want to be seen as doing something active to attract investments. The easiest approach tends to be to give up revenue that they do not have.

2.2.2 Investment Incentives and their Rationale

Investment incentives have been around for over 100 years (Thomas, 2007, p.1). In the 19th century America, Cities offered money to railroads in order to have the railway pass through them (Sbragia, 1996). But it was only in the late 20th century that governments around the world began offering direct grants, tax breaks, training funds, free infrastructure and other inducements to attract corporate investment. While often thought of as a competition to attract foreign direct investment, competition is equally strong for domestic firms. The most intense competition and the largest subsidies are given to well-known multinational companies who make large investment. At the local level, incentives may be given to a specific group of investors or investment in order to capture tax revenue that would otherwise go another jurisdiction.

2.2.3 Objectives of Tax Incentives

Tax incentives have been used by countries to achieve a variety of different objectives, not all of which are equally compelling on conceptual grounds. Stimulating investment in general, and in most developing countries, attracting FDI in particular is usually the primary motivation for granting tax incentives. Other commonly cited objectives include reducing unemployment, promoting specific economic sectors or types of activities as a matter of either economic or social policy or addressing regional development needs (Zee et al. 2002).

For a tax incentive to be beneficial to the host country, the decrease in government revenues resulting from the incentive would have to be more than offset by the increase in tax revenues resulting from increased foreign investment flows.

Generally, targeted tax incentives should be designed with the clear purpose of attaining increased investment in the field intended. Otherwise, unintended results may ensue in addition to revenue loss (UNCTAD, 2000).

2.2.4 Types of Tax Incentives

According to Bolnick (2004), tax incentives can be classified as direct tax incentives and indirect tax incentives

2.2.4.1 Direct Tax Incentives

❖ Low Statutory Tax Rate

A low standard rate applies uniformly to all profitable business activities without biasing the allocation of capital, the choice of production technology, or the form of financing.

Lowering the tax rate can be very effective. The main drawback is the impact on revenue. This is because the tax relief accrues to all businesses, whether or not they are undertaking new investments. Normally, a substantial reduction in the company tax rate is packaged with other measures that enhance revenues.

❖ Preferential Tax Rates

Preferential tax rates are tax-rate reductions that apply to designated sectors, such as manufacturing or agriculture; or to activities with particular characteristics, such as a listing on the stock exchange; or to selected beneficiaries based on discretionary screening criteria.

❖ Tax Holidays

A tax holiday is a preferential tax rate with a limited duration (often five years). Tax holidays are surprisingly popular in developing countries, considering how harshly they are criticized by tax specialists. The revenue loss from a tax holiday depends on multiple factors, including the size and scope of the tax break, the length of the holiday period, and characteristics of each investment project. A zero rate over a long period obviously entails a maximum revenue loss. As with a preferential tax rate, the value of a holiday is greatest for projects that are highly profitable which are most likely to go ahead even without the tax break.

❖ Capital recovery Incentives-Accelerated Depreciation and Initial Capital Allowances

Accelerated depreciation front-loads the capital allowance for tax purposes, relative to the economic rate of capital consumption. The true pattern and rate of depreciation is not generally known, so any designated depreciation schedule is somewhat arbitrary.

Initial capital allowances (ICAs) are special capital write-offs that enhance cost-recovery at the start of a project. The ICA is a percentage of the asset cost that can be written off in the first year (or the first few years).

❖ **Investment Tax Credits**

Zee, et al. (2001, p.1504) cited by Bolnick (2004), advocate investment tax credits (ITCs) as the preferred form of tax incentive. They note that an ITC is equivalent to an initial allowance if there is a single company tax rate. Hence, the two approaches generally “share the same advantages and shortcomings,” as outlined above. If there are multiple company tax rates, then the ITC is more even-handed than the investment allowance. This is because the IA has greater value to companies that face the higher tax rate, companies that the tax system is designed not to favor.

❖ **Treatment of Dividends**

With a classical tax system, business income is taxed once at the company level and again when remitted to shareholders. The double taxation sharply increases the effective tax rate. It also creates a bias in favor of debt instead of equity financing, and diminishes the incentive to invest.

Integrating the company tax and the dividend tax is therefore an important way to improve investment incentives and reduce the tax bias favoring debt. The revenue effect of moving to an integrated tax system depends on how much revenue is collected on dividend income.

❖ **Extra Deductions**

Some countries allow companies deductions greater than 100 percent for certain categories of expenses such as approved training programs, research and development, or export marketing. The extra deduction amounts to having the treasury shoulder a share of the cost via tax relief.

In most cases the extra deduction is applicable to all companies, but they can also be part of a selective incentive package, for example in connection with export processing zones.

2.2.4.2 Indirect Tax Incentives

❖ **Export Incentives and Export Processing Zones**

The most widespread form of indirect tax benefit for investors is relief from tax on inputs that are used to produce items for export. This vital measure to strengthen incentives for outward

looking investment is consistent with international norms. Both conventional practice and WTO rules apply the destination principle to indirect taxation of traded goods and services. Put simply, exporters should have access to inputs without paying indirect tax imposed by the country of origin. Eliminating this burden is fully justified and should be viewed as the correction of a tax distortion which would otherwise impede the incentives for efficient export production.

The burden of VAT is normally eliminated by zero-rating export sales. The import duty can be eliminated in several different ways. One common approach is to designate certain locations as export processing zones (under various names), or certain facilities as bonded production units.

❖ **Reduced Import Duty on Capital Goods and Raw Materials**

Cutting the duty on capital goods (relative to other imports) creates significant economic distortions. Most important, it biases resource allocation by favoring capital-intensive investments over those that use labor more intensively. This incentive also hinders the development of a domestic capital goods industry because the benefit is tied to the use of imported capital goods. Domestic machine tool producers often face negative effective protection as a result of this policy because they pay duty on some of their inputs while trying to compete against duty-free imports.

❖ **Protective Tariffs**

Protective tariffs can be highly effective in drawing resources into import-competing production activities. In years past, steep tariff barriers were a common feature of the policy landscape in most developing countries. However, this strategy usually ended up breeding highly inefficient investments, at a high cost to domestic consumers.

2.2.5 Cost and Benefits of Tax Incentives

2.2.5.1 Costs of Tax Incentives

According to Bolnick (2004) and Zee et al. (2002), in considering the costs of tax incentive regime, it may be useful to examine four different types of costs: (i) Revenue costs; (ii) Resource allocation costs; (iii) Enforcement and compliance costs and (iv) The costs are associated with the corruption and lack of transparency.

❖ **Revenue Costs:** The tax revenue losses from tax incentives come from two primary sources: first, foregone revenue from projects that would have been undertaken even if the investor

did not receive any tax incentives; and, second, lost revenue from investors and activities that improperly claim incentives or shift income from related taxable firms to those firms qualifying for favorable tax treatment.

An additional revenue cost of tax incentives results from erosion of the revenue base due to taxpayers abusing the tax incentive regimes to avoid paying taxes on non-qualifying activities or income. This can take many forms. Revenue losses can result where taxpayers disguise their operations to qualify for tax benefits. For example, if tax incentives are only available to foreign investors, local firms or individuals can use foreign corporations through which to route their local investments. Similarly, if tax benefits are available to only new firms, then taxpayers can reincorporate or set up many new related corporations to be treated as a new taxpayer under the tax incentive regime.

- ❖ **Resource allocation costs:** If tax incentives are successful, they will cause additional investment in sectors, regions or countries that would not otherwise have occurred. Sometimes this additional investment will correct for market failures. Other times, however, the tax incentives will cause allocation of resources that may result in too much investment in certain activities or too little investment in other non-tax favored areas.
- ❖ **Enforcement and compliance costs:** There are resource costs incurred by the government in enforcing the tax rules and by taxpayers in complying. The cost of enforcement relates to the initial grant of the incentive as well as the costs incurred in monitoring compliance with the qualification requirements and enforcing any recapture provisions on the termination or failure to continue to qualify. The greater the complexity of the tax incentive regime, the higher the enforcement costs (as well as compliance costs) may be (Joel, 2012).
- ❖ **Opportunities for corruption:** Several recent scholars have focused on the possibility of corruption and other rent-seeking behavior associated with the granting of tax incentives. There are several different approaches to providing the qualification requirements for tax incentives. The opportunity for corruption is much greater for tax incentives regimes where officials have wide discretion in determining which investors or projects receive favorable treatment. The potential for abuse is great where no clear guidelines exist for qualification.

2.2.5.2 Benefits of Tax incentives

According to Wells et al. (2001), tax incentives clearly enhance returns on investment; they may be justified by positive externalities stemming from investments; they are relatively easy to

target and fine tune; they signal openness to private investment; they are useful in a world of capital mobility; they are necessary for responding to tax competition from other jurisdictions; and they compensate for other deficiencies in the investment climate.

According to Alex and Eric (2001), Tax incentives may yield different types of benefits. The benefits from tax incentives for foreign investment follow the traditional list of benefits resulting from foreign direct investment. These include increased capital transfers, transfers of know-how and technology, increased employment, and assistance in improving conditions in less-developed areas.

Foreign direct investment may generate substantial spillover effects. For example, the choice to locate a large manufacturing facility will not only result in increased investment and employment in that facility, but also at firms that supply and distribute the products from that facility. Economic growth will increase the spending power of the country's residents that, in turn, will increase demand for new goods and services. Increased investment may also increase government tax revenue either directly from taxes paid by the investor (for example, after the expiration of the tax holiday period) or indirectly through increased tax revenues received from employees, suppliers, and consumers.

One can provide a general description of the general types of benefits of additional investment resulting from tax incentives. It is difficult, however, to estimate the benefits resulting from tax incentives with any degree of certainty. Sometimes the benefits are hard to quantify. Other times the benefit accrues to persons other than the firm receiving the tax benefits.

2.2.6 Effectiveness of Tax Incentives

As governments compete for development in an effort to expand their tax base and determine the most efficient use of limited resources to improve their communities, a critical question is if the use of tax incentives is an effective and efficient use of public dollars to encourage economic development (East West Get Way, 2011: p.65).

According to Bolnick (2004), the effectiveness of tax incentives will be viewed through four lenses:

- i. Effectiveness in stimulating investment:** The basic indicator of effectiveness is the extent to which each tax tool improves investment incentives by reducing the marginal effective

tax rate. This gives a rough approximation but not a pat ranking, since differentials vary depending on the type of project and other characteristics of the tax system. Effectiveness also depends heavily on whether the incentives accrue to marginal investments or to projects that would be undertaken anyway. When tax benefits are redundant, the beneficiary investments cannot properly be viewed as arising from the incentive program.

- ii. **Revenue foregone:** To measure the generosity of each instrument, one can calculate the revenue foregone per beneficiary. But a larger consideration is the number of beneficiaries: does the benefit accrue to every filer, to new investments only, or to a selective subset of new investments? The smaller the set of beneficiaries; the lower the tax loss; other things being equal. A second major factor is whether the incentive is carefully targeted to investments that would otherwise be lost to the economy. If so, then the effective revenue loss is zero. If the incentives are redundant, however, then the tax break is a straight loss to the treasury.
- iii. **Economic efficiency:** Various tax instruments introduce different kinds of economic distortions, which bias investment decisions and reduce efficiency.
- iv. **Tax administration:** Tax incentives also differ in terms of administrative simplicity, the ease estimating the foregone revenue (tax expenditures), and the scope for abuse. The latter should be a central consideration for the design of any tax incentive program.

The international empirical evidence that incentives are important component in investor's decision making is quite mixed. There seems to be more evidence in the developing country context that incentives can matter particularly for export industries but also the evidence is quite strong that, particularly in the developing country context, the economic and political environment is key (Chalk, 2001).

2.2.7 Tax Expenditure

Tax expenditure, in broad terms, is a tax provision that deviates from a normative or a benchmark tax system. Tax expenditures may take a number of forms: exclusions, exemptions, allowance, deductions, credits, preferential tax rates, or tax deferrals. Tax holidays and tax free zones are tax expenditures subject to specific time periods or geographical areas (Liswift, 2006).

Tax expenditures, understood to be the revenue that is foregone by the application of benefits or special tax regimes, are one of the many tools that governments have available for public policy implementation. Their use is designed to foster and encourage certain economic sectors, activities, regions, or agents. Tax expenditures are often referred to as “foregone revenue” since they can be considered as the way by which the treasury desists, either partially or totally, from applying the general tax regime to pursue a higher objective of political economy or social policy (Villem, 2010).

The concept of tax expenditures arose at the beginning of the 1960s, practically simultaneously in Germany and the United States. These were the first countries to report tax expenditure budgets to enhance transparency in public activities carried out via this method, in the same way they reported direct public spending in the regular budget process. Later, during the 1980s, the practice was extended to virtually all countries in the Organization for Economic Co-operation and Development (OECD) and to a few developing countries.

The international community’s demands for greater transparency in fiscal policy, together with the growing tendency to use tax benefits especially in those developing countries seeking investment led to an increased interest in tax expenditures throughout the world (Pogue, 2008).

Tax expenditures can take different forms, such as the following:

- I. Exemptions: Revenue or transactions that are excluded from the tax base. In legal regulations, these are encountered under various headings (e.g., exemptions, tax holidays, nontaxable events, etc.).
- II. Allowances: Amounts that can be deducted from the tax base.
- III. Credits: Amounts that can be deducted from the tax liability.
- IV. Rate relief: Lower tax rates than those generally applied.
- V. Deferral: Postponement or delay in the tax payment.

2.2.8 Considerations in Designing Investment Incentives

The effectiveness of investment incentives depends on their proper design and implementation. Incentives need to be carefully design to achieve a specify policy goal. Poorly targeted tax incentives prove ineffective and expensive (Jordan, 2012, p.8). If properly designed and implemented, tax incentives may be a useful tool in attracting investments that would not have

been made without the provision of tax benefits (Easson and Zolt, 2002). The processes and procedures by which incentives are designed and implemented are important in determining their effectiveness (Barbour, 2005:6). Unless government adopt proper process and procedure in granting any investment incentive, the purpose it is intended for, will not be attained. Zolt (2014) in his work on UN project on protecting the Tax Base of Developing Countries identified some crucial considerations to be taken into account in designing tax incentives. Such as, Eligibility criteria; Process for qualification; Scope of benefits; Reporting and monitoring requirements, Recapture provisions; Review and sunset provisions.

2.2.9 Administration of Incentives

In the absence of proper monitoring and control, exemption programs are open to rent seeking and to abuse. Exemption permissions must be designed to ensure that they are not used as a “back door” to avoid normal import duty obligations (Bajracharya and Flatter, 1999, p.6). Perea in his paper conducted, in 2012, suggests that policy makers should develop tax incentives, according to the three T’s-timely, targeted and temporary;

- ✚ Stipulate by law the length of the incentive period and the entities eligible for incentives
- ✚ Administer incentives through corporate tax code.
- ✚ If incentives are awarded through legal instruments and regulations other than corporate tax codes, these provisions should be mirrored in the tax code
- ✚ Mandate tax authorities to administer the award and monitoring of the incentives. This will lower administrative costs and increase transparency as tax authorities are best placed to ensure that investors receiving incentives are eligible and provide the necessary documentation.
- ✚ Avoid the granting of discretionary incentives, whether through bilateral negotiation or certification.
- ✚ Process applications for incentives quickly, to promote transparency and reduce opportunities for abuse. One-stop-shop services for company establishment and the services of special economic zones and industrial parks are useful.

2.2.10 Administrative Challenges of the Investment Incentives

Governments in developing countries face pressures from various sources including developed countries and donor financial institutions to improve their tax system to promote both FDIs and domestic investments. Moreover, most investment agencies believe investment incentives as the major tools to promote investment. These lead many governments to grant various incentives to achieve their investment goals. Nevertheless, the effectiveness of the investment incentive depends on the like the political and economic situations of the country, legal frameworks and administrative arrangements, important considerations taken in the process of designing the incentives, administrative capacity of the country and honesty of the beneficiaries Lent (1967)..

Properly designed legal framework is the key in the administration of incentives. Determining the eligibility of a proposed investment projects for the incentives provided in the laws usually depends not only on the criteria written in the law but also on the procedures established for their interpretation and application in each case. Some laws are more or less clear and automatic in their application and other have administrative procedure in determining eligible projects Lent (1967).

Administration of incentives needs competent administrative body. Incentives necessitate governments to implement strong administration and reduce their misuse. They can impose unnecessary costs on investors and prone to corruption (James, 2010). The potential costs of administering investment incentives may include wastage if both human and other resources. If the incentive system is poorly designed the government may collect unexpected outcome. Therefore, well-designed, Clear and transparent application and screening procedures, and an effective tax administration regime with ‘bite’, are crucially important to the ultimate credibility and success of a tax incentive programmers (Jordaan, 2012). This suggests that, the administration of incentives begin from its design stage. In this stage, the incentives to be implemented should be clearly known with their clear criteria to be eligible. The procedures of implementation and the powers and responsibilities of the administrative bodies should be clearly known. The system should be designed in a way ensures transparency. In principle only tax administrations should administer tax incentives. However, many government agencies involve in the implementation of the incentives. This causes administrative difficulties for the administrative bodies legally assigned to administer the incentive programs. That is the

involvement of various institutions complicates the incentives system and become a challenge for the administration.

Failure to take in to account necessary considerations that should be taken in to account is among challenges in the administration of investment incentives. Administration of the incentives needs strong administrative capacity. This is because: the individuals and companies that would be eligible for the benefits have better power to influence the system. As the result, the system could be misused. Analysis should be done regarding administrative capacity of the country. In addition, as suggested by James (2009, 2010), Eligibility for incentives provided by law should be based on clear criteria, not granted through special agreement or qualifications by investment promotion agencies, deferent ministers or to their government agencies. That is, all incentives should be included in specific laws with their clear eligibility criteria.

There should not be subjective bargaining with the investors. Moreover, to ensure proper consideration of revenue objectives, that minister responsible for finance must be centrally involved in the formulation of tax incentive policies (Bolnick, 2004). The reason is the investment incentives reduce revenue that could be collected from relatively wealthy investors. Therefore institutions responsible to tax and finance should participate in the designing and formulation of incentives. It's time to examine the administrative capacity they actually have and comment on how those incentives would be administered. Those incentives should be consistent with revenue collection objective of the country. The incentives designed regardless of the administrative capacity of administrative body of the country are prone to abuses. Likewise, in the absence of clearly set criteria of eligibility, it creates an opportunity to rent seeking and corruption. Therefore, incentive system designed without taking in to account necessary considerations are difficult to implement in proper way.

Incentives are prone to abuses. Investors have no reason to comply with their legal requirements in the absence of strong monitoring and controlling mechanisms. They are there to maximize their capital. The issue of competition could also not be undermined. Consequently, the controlling and monitoring capacity of administrative body is crucial tool. Preventing and controlling the abuse of loopholes absorbs highly skilled administrative resources (Bolnick, 2004). More trained and experienced officers may be required to participate in implementation of incentive and examining their performance.

That is, the scarce resources of the tax authority would be used for the administration of investment incentives. Other more important administrative tasks would be weak. Finally, this could affect revenue collection as a whole. On the other hand, investment incentives could be abused in the absence of strong administration. Thus, abuses of incentives impose administrative burdens on tax administration.

Another challenging task in the administration of investment incentives is establishing effective administrative and monitoring mechanisms and achieving simplicity in the incentives system. As stated by Bolnick (2004) "Failure to monitor encourages false applications, places public revenue unduly at risk, renders useless any penalty or sanction clauses, and makes it virtually impossible for the government or the public to ascertain the effectiveness of the tax incentive programs" investors receiving incentives should satisfy both legal and administrative requirements. The tax administration authority should ensure the satisfaction of every necessary requirement while they claim for the incentives. The government does not have reason to give up public revenues for private individuals in the absence of something to get back. This means, its proper implementation should be strictly scrutinized.

Therefore, there should not be reason to exclude investment incentives from close controlling and monitoring of tax administration in the ways of requesting relevant information, continuous audits, and any other compliance requirements. In doing so, the tax administration could use various mechanisms including compulsory tax returns and filing, regular declarations of income, and continuous filed monitoring and others. However, as other government institutions do, tax administration has its own objectives. The resources allocation is also on the basis of these objectives. On the other hand it's required to perform controlling and monitoring tasks of investment incentive which do not have direct effect its revenue collection objectives. Therefore, establishing effective mechanisms of monitoring and controlling investment incentive simultaneously with its objectives is challenging task for the tax authority.

In general, poorly designed legal and administrative frameworks, failure to take some important considerations into account, abuses and difficulty to establish appropriate monitoring and controlling mechanisms are the major administrative challenges of investment incentives for tax administration.

2.2.11 Implementation and Compliance Issues

2.2.11.1 Monitoring of the Compliance

Investors, who are incentives beneficiaries of investment incentives, have to comply with tax laws and any other laws of the country, both initially with qualifying conditions investment through their investment performance. (Easson and Zolt, 2002) noted that compliance should be ensured both initially with Qualifying Conditions and Monitoring Continuing Compliance.

2.2.11.2 Techniques to Abuse Investment Incentives

Opponents of tax incentives argue that incentives are ineffective inefficient and prone to abuse and corruption. To put it another way, investment incentive may lead to exploitation of public revenue unless they are administered appropriately. The potential for abuse is great where no careful granting procedure, clear requirements and strong continuous monitoring and controlling administrative procedures exist to ensure its effectiveness. On-going monitoring of investment incentives is necessary not only to ensure continued compliance with qualifying conditions, but also to detect tax avoidance or evasion. Easson and Zolt (2002, p.-31-34) have identified various ways that investors (taxpayers) abuse their incentives:

- ✚ Round-Tripping-Typically occurs where tax incentives are restricted to foreign investors or to investments with a prescribed minimum percentage or foreign ownership.
- ✚ Double dappling-May tax incentives, especially tax holidays, are restricted to new investors. In practice, such a restriction may be ineffective and may be counterproductive. An existing investor that plans to expand its activities will simply incorporate a subsidiary to carry on the activity, and the subsidiary will qualify for a new tax holiday. A different type of abuse occurs where a business is sold towards the end of the tax holiday period to a new investor who then claims a new tax holiday; sometimes the “new” investor is related to the seller, though the relationship is concealed.
- ✚ Transfer pricing- The tendency is to think of transfer prancing as a phenomenon that occurs internationally in transactions between related enterprises in different countries. Transfer pricing can also take place in a single country where an investor has two or more operations within a country or where the investor derives income from more than one activity. If one of those operations, or one type of income, enjoys a tax preference, profits will tend to be allocated to the preferred activity.

- ✚ Over-valuation-Over-valuation (or sometimes under-valuation) is a constant problem in any tax system. Tax incentives, however, may provide additional temptations to inflate the values of assets. For example, where a tax holiday is conditional upon a certain minimum amount being invested, the value of assets contributed to the new firm can be manipulated to achieve the target figure. Sometimes this is done legitimately.
- ✚ Abuse of duty-free privileges- A danger is that, once imported, items may be resold on the domestic market.
- ✚ Asset stripping and “fly-by-night” operations-operators that take advantage of tax incentives to make a quick, tax-free, profit and then disappear to begin operations in any other country that offers tax privileges.
- ✚ Corruption- the granting of tax incentives, especially where the process involves a substantial degree of discretion, is one situation where there is a strong risk of corruption.

2.2.12 Experience of Some Countries

Two success stories of eliminating tax incentives: Uganda (1997) and Indonesia (1984).

Uganda (1997)

A major tax reform took place in Uganda in 1997. This reform included complete elimination of new tax holidays in favor of a rate of 30 percent on company income, with generous capital allowances for all investors and unlimited loss-carry forward. A zero import duty was also set on a wide range of capital goods. The elimination of selective incentives also greatly simplified investment licensing.

The main effects of this tax reform were (comparing averages of three years before and after 1997): an increase of one percentage point in the ratio of investment to GDP, 70 per cent increase in foreign investment inflows, and a one percent of GDP increase in tax revenue.

It is worth it to note that despite these positive effects, business appealed once again for tax incentives in 1998, when asked what the government could do to improve the business environment.

Indonesia (1984)

In 1984 an ambitious tax reform took place in Indonesia whose main aims were reducing administrative costs, and economic distortions, increasing equity and reduce evasion and

corruption. The company tax rate was reduced from 45 per cent to 35 per cent and selective tax incentives were totally eliminated; including tax holidays, preferential rates, special investment allowances and selective accelerated depreciation.

Despite the strong fear that foreign investors would shun Indonesia in favour of countries like Malaysia and Singapore, the number of FDI projects dipped in 1984 but then climbed rapidly for the rest of the decade. Additionally, in value terms, FDI fell from a plateau achieved the previous two years, but then soared to new heights after 1987.

Once again, despite these positive effects, pressure to restore tax incentives has been persistent, and in 1994 (several exemptions) and 1996 (discretionary tax holidays, although dropped in 2000 in favor of a new tax allowance and accelerated depreciation) some incentives were reintroduced (Clark, et al. 2007).

In general when considering the introduction of tax incentives, governments should take into account: the best practices on the use and design of tax incentives, they should assess in advance tax incentives targeted to boost investment. If introduced, the tax incentives should be evaluated (using cost benefit tests) on periodic basis to measure whether their effectiveness. On the other hand, to enable proper evaluation and assessment, the specific goals of a given tax incentive need to be explicit at the outset and sunset clauses calling for the expiry of the incentive should be included to provide opportunity to assess whether the availability of the incentive should be extended or not.

2.2.13 Tax Incentives in Ethiopia

The 1992/93 Ethiopian Government Economic Reforms Program (ERP) has been modernizing tax and custom administration by overhauling the legislation and improving administration. The effort was aimed at concerning trade, investment and development. The tax policy is geared towards promoting private investment, supporting industrial development and broadening the tax base and decreasing the tax rate in the view of raising sufficient friendly and attract foreign direct investment, Ethiopian Government has been providing a wide range of fiscal incentives (ERCA, 2011)

The first investment code, proclamation No 15/1992 of May, 25 1992 was aimed at encouraging private investment. The transitional Government of Ethiopia (TGE) in this proclamation issued

areas eligible for investment incentives were limited to manufacturing and agriculture sectors. The incentives provided were 100% exemption from customs duty on importation of capital goods and income tax holiday ranging from 1-8 years based on type and region of investment. This proclamation served for four years and replaced by proclamation No.37/1996 in June 1996. Health, Education, Tourism and construction sectors were included in the areas eligible to incentives. In addition the revision reduced the capital gain tax from 40% to 10%, opened the real estate sector and Electricity and water supply for foreign investors and extended the losses carried forward provision.

The investment code (Proclamation No.37/1996 again replaced by proclamation No.116/1998 in June 1998. The new code allowed the private sector invests in defense and telecommunication jointly with Government. The amendments of July 2002 (Proclamation No. 280/2002) and September 2012 (Proclamation No 769/2012) further liberalized the investment regime, removing most of the remaining restrictions and opened all areas of investment for foreign investors. Banking, insurance and microcredit and saving services, forwarding and shipping agency services, broadcasting services and air transport services using aircraft with a seating capacity of up to 20 passengers were reserved for Government, Domestic investors and Ethiopian nationals.

Based on proclamation no. 769/2012; the types of incentives practiced in Ethiopia are listed below:

2.2.13.1 Fiscal Incentives

i) Customs Duty's Exemption:

To encourage private investment and promote the inflow of foreign capital and technology in to Ethiopia, the following customs duty exemptions are provided for investors (both domestic and foreign) engaged in eligible new enterprises or expansion projects such as agriculture, manufacturing, agro-industries, construction contracting, etc.

Total exemption from the payment of customs duties for investors engaged in different sectors except those in Real estate development (sch. no.7), Publishing (sch. no. 11), Export trade (sch. no. 14), and Whole sale trade (sch. no. 15) may import duty free capital goods and construction

materials necessary for the establishment of a new enterprise or the expansion or upgrading of an existing enterprise.

If an investor entitled to duty-free incentives buys capital goods or construction materials from local manufacturing industries, he shall be refunded with the customs duty paid for the raw materials or components used as inputs for the production of such goods.

Spare parts worth up to 15% of the total value of the imported investment capital goods, provided that the goods are also exempt from the payment of customs duties within five years from the date of commissioning of his project;

An investor granted with a customs duty exemption will be allowed to import capital goods duty free any time during the operational phase of his enterprise.

Investment capital goods imported without the payment of custom duties and other taxes levied on imports may be transferred to another investor enjoying similar privileges.

ii) Income Tax Exemption:

If an investor engaged in new manufacturing, agro-processing, the production of agricultural products and investment areas of information and communication technology (ICT) development:

Exports 50 percent of his products or services, or supplies 75 percent of his products or services as production or service input to an exporter will be exempted from income tax for 5 years. Under special circumstances, the investment board may grant income tax exemption up to 7 years and the Council of Ministers may pass a decision to grant income tax exemption for more than 7 years;

Exports less than 50 percent of his products or services, or supplies his products or services only to the domestic market will be exempted from payment of income tax for 2 years;

Exports, through the expansion or upgrading of his existing enterprise, at least 50 percent of his products or services and increases, in value, his products or services by over 25 percent will be exempted from income tax for 2 years;

For each case mentioned above, the length of the tax exemption period may be extended for one additional year when the investment is made in relatively under-developed regions of the

country. However, investors who export hides and skins after processing below crust level are not eligible for income tax exemption.

Investors who invest in priority areas (textile and garments, leather products, agro-processing, etc.) to produce mainly export products will be provided land necessary for their investment reduced lease rates.

iii) Loss Carry Forward

Business enterprises that suffer losses during the income tax exemption period can carry forward such losses, following the expiry of the exemption period, for half of the exemption period.

iv) Export Incentives

The fiscal incentives given to all exporters are the following:

With the exception of few products (e.g. semi-processed hides and skins), no export tax is levied on export products of Ethiopia;

Duty Drawback scheme: it offers investors an exemption from the payment of customs duties and other taxes levied on imported and locally purchased raw materials used in the production of export goods. Duties and other taxes paid are drawn back 100 percent at the time of the export of the finished goods.

Voucher scheme: A voucher is a printed document having monetary value which is used in lieu of duties and taxes payable on imported raw materials. The beneficiaries of the voucher scheme are also exporters.

Bonded manufacturing warehouse scheme: producers not eligible for voucher scheme but having licensed for bonded manufacturing warehouse are entitled to operate such warehouse in importing of raw materials duty free.

2.2.13.2 Non Fiscal Incentives

Investors who invest to produce export products will be allowed to import machinery and equipment necessary for their investment projects through suppliers' credit; Investors who invest in areas of agriculture, manufacturing, and agro-industry will be eligible to obtain loan up to 70 percent of their investment capital from the Development Bank of Ethiopia (DBE) if their investment is sound to be feasible; and the Government of Ethiopia will cover up to 30 percent

of the cost of infrastructure (access road, water supply, electric and telephone lines) for investors investing in industrial zone development.

Exporters are allowed to retain and deposit a bank account up to 20 percent of their foreign exchange export earnings for future use in the operation of their enterprises and no export price control is imposed by the National Bank of Ethiopia; Franco-valuate imports of raw materials are allowed for enterprises engaged in export processing; and Exporters can benefit from the export credit guarantee scheme which is presently in place in order to ensure an exporter receives payment for goods shipped overseas in the event the customer defaults, reducing the risk of exporters' business and allowing it to keep its price competitive.

2.3 Empirical Literature Review

In this subsection, experiences of different countries and previous researches conducted by different researchers are reviewed. Both developed and developing countries in the world design and utilize various investment incentives based on the investment policy goals. In spite of doubts in their effectiveness, investment incentives remain a popular tool of investment encouragement in both developing and developed countries. Especially, as Lent (1967, P.251) describes, developing countries provide many different types of tax concessions to attract foreign and domestic capital. Their principal purpose is to enhance the profitability of a newly established business or expansion of an existing business which will contribute to the country's economic objectives.

Therefore, it's important to review some countries lessons of experience regarding the investment incentives administration. Because, of their historical success, failure or problems in their utilizing and administration of investment incentives, the experiences of selected countries have been reviewed. This helps us analyze how and what kinds of incentives have been carried out in these countries and this in turn provides the basis for drawing some lessons for Ethiopia.

As a research conducted by the integrated social Development Centre (ISODEC) (2014) reveals, Ghana was ranked as a lower middle income country in 2012. The country is yet struggling to mobilize adequate resources to address her developmental challenges. To achieve its development objective, the country has been granted various investments objectives. The principal law which gives expression to tax incentives in Ghana is the Internal Revenue Act 2000

as amended. The Act together with other sector specific laws and agreements embody the entirety of tax incentives in Ghana.

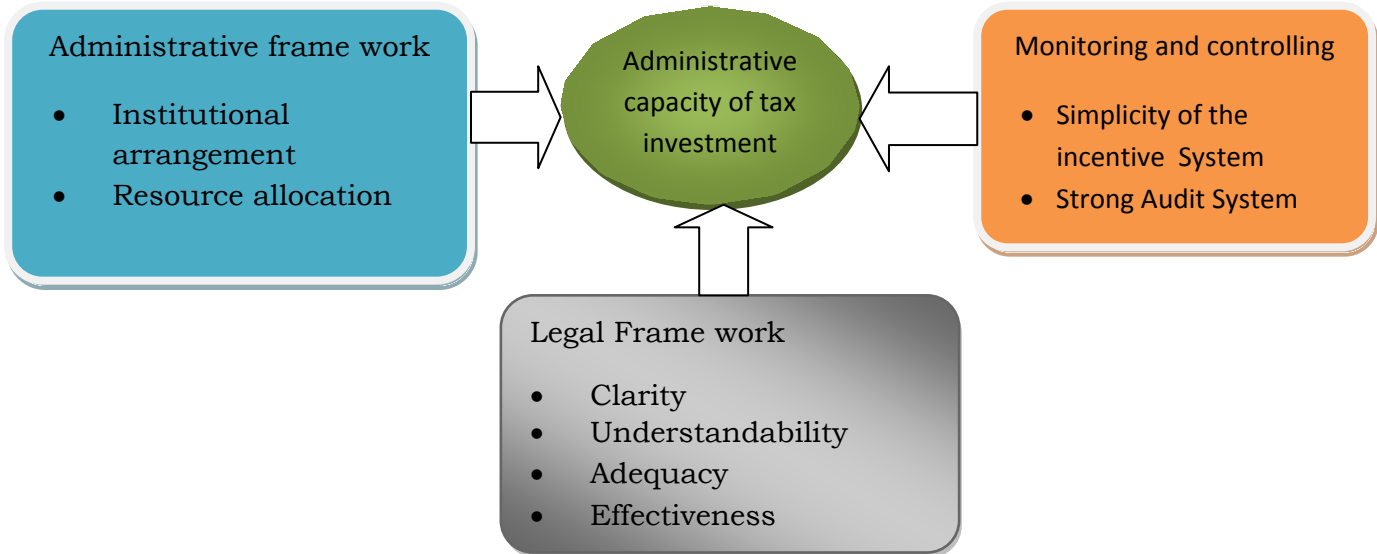
The finding of the research, among other point out that, the legal and administrative tax framework in Ghana is fragmented and not properly coordinated for monitoring and evaluation purposes. This has invariably resulted in an unevaluated tax incentive system which has the potential of facilitating illicit transactions and financial outflows abroad; Discretionary tax incentives contribute significantly to the tax incentive system which may be leading to the overall increased levels of most inappropriate tax incentives. Thus, the important lesson can be drawn here is not properly coordinated and fragmented legal and administrative result in abuse of incentives.

Some researchers associate ineffectiveness of investment incentives with its improper design and administration. For instance, Kransdorff (2010) in his study “Tax Incentives and Foreign Direct Investment in South Africa” has demonstrated that South Africa’s fiscal incentive regime also appears to lack strategic focus. South Africa’s tax incentive schemes have also failed to significantly advance the economic development of poorer regions. These problems are compounded by the fact that there is no single government agency charged with overall responsibility for the design and implementation of incentives. He also identified potential revenue loss; long run economic distortions and Rent seeking and corruption as risks of tax incentives.

Investment incentives impose substantial administrative and compliance costs on both governments and foreign investors (Kransdorff, 2010, p. 79). The introduction of special investment incentives inherently complicates tax administration and creates loopholes through which companies and wealthy taxpayers avoid or evade other tax obligations (Bolnick, 2004, p. 1-3); complex legislation, skilled staff and sophisticated systems are needed to prevent tax avoidance, diverting limited resources from other important administrative tasks (Flatters, 2004). Thus Kransdorff (2010) worry that while tax incentives may increase South Africa’s FDI Inflows, if not managed effectively, they could have a detrimental effect on the country’s economy.

2.4 Conceptual Framework

The following factors are drawn as the major factors that affect the administration of the investment incentives.



Source: Literature review Compiled by the Researcher

Legal framework is a broad system of rules that governs and regulates decision making, agreements & laws, monitoring is supervising activities in progress to ensure they are on-course and on-schedule in meeting the objectives and performance targets, monitoring is the basic management functions of (1) establishing benchmarks or standards, (2) comparing actual performance against them, and (3) taking corrective action, if required and also framework is broad overview, outline, or skeleton of interlinked items which supports a particular approach to a specific objective, and serves as a guide that can be modified as required by adding or deleting items.

From the frame work above; it's possible to understand that administrative capacity of tax incentives can be affected by various factors. These factors include legal framework, administrative framework and monitoring and controlling mechanisms applied. As shown in the framework; the legal framework should be well- designed in clear and understandable form. It should also be adequate and effective. All incentives should be included in relevant tax law. The law should clearly state the powers and responsibilities of administrative bodies involve in the system and incorporate economically meaningful penalty in cases of misuse. Like wish, the designing process should take all necessary consideration in to account. There should be clear administrative framework and appropriate monitoring & controlling mechanisms in order to reduce abuses of incentives.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

In this part, the researcher deals with the logic behind the methods used in the context of the research study and explains why a particular method or technique is used, why not other methods used so that research results are capable of being evaluated either by the researcher or by others. Why a research study has been undertaken, how the research problem has been defined, in what way and why the research questions have been stated, what data have been collected and what particular method has been adopted, why particular technique of analyzing data has been used are usually answered in research methodology concerning a research study (Kothari, 2004).

3.2 Research Design

According to a definition provided by Kothari (2004:31), a research design constitutes decision regarding what, where, when, how much, by what means concerning an inquiry or a research study is going to be conducted. In general, therefore, it seems that research design is work plan that states what objectives the research is going to achieve; how these objectives would be achieved; where from the information would be collected and by using what types of tools.

To achieve the objective of the study, descriptive type of research was deemed appropriate. It was supported by appropriate explanation of the existing situation. As stated by Kothari (2004:2), the major purpose of descriptive research is a description of the state of affairs as it exists at present. Consequently, by using a descriptive type of research; the researcher was able to obtain information concerning the existing challenges of tax incentives in the study. Thus, the researcher was able to report the existing incentive challenges & impacts and recommend possible remedies. Moreover, it was also attempted to discover causes even if it is not possible to control the variables by using this research type.

This study employed mixed (Qualitative and Quantitative) methods of research. Particularly, the survey method, interview, questionnaire and documentary analysis were used. To address the research problem by using a survey method, the researcher used structured and self-administered questionnaire. This enabled the researcher gather a mix of qualitative and quantitative information. In addition, it was possible to administer both over the telephone and face to face.

One of the grounds to use self-administered closed ended questionnaire was because of its low cost requirement and not consume much time to be answered by the respondents and quicker to administer by the researcher. Moreover, an open ended questionnaire was also employed. The reason is that, it invited free ranging response, sometimes called verbatim response. Such responses were very useful for obtaining a deeper understanding of the respondents' views and opinions towards tax incentives.

The study applied both qualitative and quantitative (mixed) research approach that helped the researcher to take the problems from different directions and to meet the objectives of the study. It was chosen because, both quantitative and qualitative data, together provide a better understanding of the research problem than either type by itself. That is, it provides a more complete understanding than either quantitative or qualitative alone. As a result, both quantitative and qualitative data were collected concurrently and the result is analyzed and interpreted by merging both data.

3.3 Sample Design

Sample design is a definite plan for obtaining a sample from a given population. It refers to the technique or procedure the researcher would adopt in selecting items from the sample (Kothari, 2004). It is the whole process of specifying the target population; determining the sample frame; selecting sampling methods; determining sample size and selecting the sample unit. Therefore, in this part, the population for which the findings would be concluded; the techniques used to select the sample unit; and the number of the sample size upon which the study was focused to conclude about the study population has been dealt.

3.3.1 Population

The populations of this study includes ERCA Enforcement Directorate Director, Tax intelligence Directorate, Team Leaders and officer, Investigation Audit Directorate & Team Leaders and Plan and Research Directorate 49, the A.A Kality Customs Branch office leaders such as Managers, Post Clearance Audit process owners & their team leaders and investment goods process unit, Enforcement process owner and its Team leaders & Officers 62, the Ethiopian Investment Agency directors, process owners, team leaders and officers 41 are the target population for the study. Thus the total population of the study was 162.

3.3.2 Sampling Techniques and Size

According to Johnson and Christensen (2008), in purposive sampling, the researcher specifies the characteristics of a population of interest and then tries to locate individuals who have those characteristics to address the objectives of the study. Kemper et al. (2003) add that researchers who use purposive sampling techniques are able to focus and minimize the sample size so that it might best reflect the purpose of the research.

Therefore the researcher used purposive sampling technique to identify the sample from the population. The rationale to use this method will be that; it invites the researcher to identify and target individuals who are believed to be typical of the population being studied. The researcher uses their own judgment about which respondents to choose, and picks only those best meet the purposes of the study. Based on this; the research interviewed 5 officials and distributed 103 questionnaires for directors, managers, process owners, group leaders and officers. Detail sample computation is shown in the following way:

Table 3.1: Size of population, Sample and Sampling Techniques.

No.	Item	Population	Sample Size	%	Sampling Techniques
1	AAKCBO Managers	3	3	100	Available
2	Law enforcement work process of AAKCBO				
	• Intelligence Team	12	12	100	Available
	• Investigative Audit Team	6	6	100	Available
	• Action Taker Team	5	5	100	Available
3	Post clearance audit work process of AAKCBO	33	20	61	Purposive
4	Enforcement Directorate director, Intelligence & Investigation Audit directorates, team leaders & officers of investigation & intelligence and plan & research directorate director of ERCA	49	23	47	Purposive
5	Investment Goods process units of AAKCBO	13	12	92	Purposive
6	Duty free directorate of EIA	41	22	54	Purposive
Total		162	103	64	

3.4 Method of Data Collection

3.4.1 Types and Sources of Data

All research can be sorted into two categories: primary sources and secondary sources. Primary sources are included: surveys, statistics, letters, interviews, autobiographies, diaries, eyewitness accounts, etc. Secondary sources were written by people with indirect knowledge. These writers relied on primary sources or other secondary sources for their information. Secondary sources include: abstracts, almanacs, biographies, book reviews, books written by nonparticipants, critical analyses, encyclopedias, explanations, government documents, indexes, interpretations, literary criticism, textbooks, web pages etc. (Rozakis, 2007).

In this study both the primary and secondary data were used. The primary data was collected from ERCA and EIA directorate, process owners, team leaders and officer's through a questionnaire data collection instrument. The secondary data was collected from various internet sources, proclamations and magazines, policy manuals, journals, from different published and unpublished reports, books, articles, annual reports of national and international organizations, different research reports, regulations & procedures and directives.

3.4.2 Data Collection Instrument (Tools)

To conduct this research, both primary and secondary data from different sources were used. Concerning the data, ten years data (2006/7 – 2015/16) of tax incentives were analyzed to show its impact on revenue collection. The data for tax incentives granted was collected from ASYCUDA and from Planning Directorate of ERCA. Questionnaire and Interview are the main instrument to collect information from the target employees of ERCA & EIA. The questionnaires comprise mainly close ended and few open ended questions. In addition unstructured and structured interview were conducted with relevant leaders of ERCA & EIA; for additional information about the challenges and impacts of tax incentives.

3.5 Data Presentation and Analysis

After the data was collected from both primary and secondary sources through qualitative and quantitative method, the results obtained were analyzed and interpreted using qualitative as well as quantitative data analysis tools. Descriptive statistics were used to analyze the frequencies of respondents perception and their level of agreement or disagreement with the given statement

under each Likert type Questions as well as for the analysis of the secondary data. After the data's were analyzed in order to illustrate the result; tables, graphs and charts were used. Microsoft excel spreadsheets were used to analyze the collected data.

3.6 Validity and Reliability

In order to achieve validity and reliability of the result, pilot-test has been conducted. That is, before distributing to actual respondents, the designed questionnaire and interview questions were distributed to some peer groups and research adviser who have well experienced in research and better academic performance. Besides it has also examined by staff members of ERCA who have knowledge on the area of the study both theoretically and practically. Thus, the feedbacks from pre-test have assisted to eliminate some irrelevant questions from both the questionnaire and interview questions. Moreover, all the questions in the questionnaire and interviews were directly related to the objectives of the study.

While conducting interview, all the questions were explained clearly and asked in a normal tone. When any confusion observed, the question would be repeated in order to enable the interviewee understand what was asked for. Moreover, all interviewees were given the freedom to explain their own beliefs and thought freely without any interference either with interpretation or signal language, which would create prejudice in the interviewee's response to the question being asked.

3.7 Ethical Issues

In the process of conducting this research, the researcher respected the rights of the participants to decide their own decisions accordance with their own interest. The participants of the study were given sufficient information about the necessity and purpose of the research. During data collection and analysis, the personal information of the respondents was kept carefully. Furthermore, the collected data was not used for any purpose other than this particular research. Any information (corporate and/ or individual nature); which is known in conducting this research; and irrelevant for this particular research have not been revealed.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATIONS

4.1 Introduction

In this chapter, the data collected through the self-administered questionnaire, interview and documents review have been presented and interpreted. This helped the researcher reach on appropriate conclusion and suggest possible recommendations.

The population used for the study was employees of the relevant departments of Addis Ababa Kality Customs Branch Office, Head Office of ERCA and duty free directorate of EIC. Thus, the total number of sample is 103. Among distributed questionnaire 7 (7%) of the questionnaires were not returned. As a result, 96(93%) of questionnaires were returned.

Data collected from both primary through questionnaire and secondary sources have been analyzed by using frequencies, percentage, bar, column, area, line and tabulation by using Microsoft offices excel 2010.

Table 4.1: Response Rate

Department	Distributed	Collected	Response rate
AAKCBO Managers	3	3	100%
Law enforcement work process of AAKCBO			
• Intelligence Team	12	12	100%
• Investigative Audit Team	6	6	100%
• Action Taker Team	5	5	100%
Post clearance audit work process of AAKCBO	20	20	100%
Enforcement Directorate director, Intelligence & Investigation Audit directorates, team leaders & officers of investigation& intelligence and plan & research directorate director of ERCA	23	21	91.3%
Investment Goods process units of AAKCBO	12	12	100%
Duty free directorate of EIA	22	17	89.5%
Total	103	96	93%

Source: Compiled from the questionnaire, 2017

The above table clearly shows that out of the total 103 questionnaires which was distributed to relevant departments of ERCA at head office level, Addis Ababa Kality Customs Branch Office and EIA, 96 questionnaires were collected. This implies the response rate was 93%. Hence, the analysis, discussion and interpretation that follow were based on the data collected from the 96 respondents.

4.2 Demographic Data of the Respondents

This section provides demographic data of the respondents. It includes the basic attributes of the respondents such as age, educational background, year of work experience and current status.

Table 4.2: Demographic Information of Questionnaire Respondents

Variables	Attributes	Frequency	%
Age	20-30	26	26.8
	31-40	69	72.2
	41-50	1	1
	Above 51	0	0
Educational background	Certificate	0	0
	Diploma	0	0
	1 st Degree	91	94.8
	Master's Degree	5	5.2
Work experience	Below 5	25	25.7
	6-10	39	41.1
	11-20	27	27.8
	21-30	5	5.2
	Above 31	0	0
Current Status	Officers	42	43.8
	Senior Officers	36	37.5
	Team Leaders	12	12.5
	Process owners/above	6	6.3

Source: Compiled from the questionnaire, 2017

Table 4.2 above demonstrates that 99% of the respondents are under the age of 40. This indicates that, the administration of incentives has been performed by the young and energetic group of people. That is, if they are supported by sufficient training and development, they could contribute a lot to the improvement of the administration of the investment incentives. Similarly, as its revealed, most of the respondents of ERCA &EIA have a first degree and only 5.2 % are the master's degree holders.

Table 4.3: Demographic Profile of Interviewed Officials

No.	Code	Sex	Age Group	Level of Education	Work Experience
1	ERCA01	M	39-50	MA	20
2	ERCA02	M	39-50	MA	22
3	ERCA03	M	39-50	MA	24
4	ERCA04	M	39-50	MA	10
5	ERCA05	M	39-50	MA	12

Source: Compiled from the Questionnaire 2017

A set of open-ended questions were asked to assess and analyze the challenges of tax incentives on government revenues and administration. The findings were then summarized according the objectives set in the research.

4.3 Factors Affecting the Administrative Capacity of Tax Incentives

As mentioned in the literature review, governments need to bear in mind the capacity of their tax administration when considering whether to implement incentives and the type(s) of incentive(s) which should be implemented. An effective incentive system must be consistent with a country’s administrative capacity. The capacity to administer can be seen in different aspects including institutional arrangement; administrative procedure: statutory measures and administrative capacity to deal with abuse of incentives. The institutional arrangement again related to human and other resource allocations in a proper manner; office and office facility, distribution and adequate budget allocation for the purpose the administration Lent (1967).

Administrative capacity can be defined in a different ways based on the context. However, for the purpose of this study, Administrative capacity is defined as the capacity of the organization and individuals in the organization to perform the assigned duties effectively, efficiently and accomplish organizational goal. It also includes the individuals’ skill and competency to administer respective tasks. Thus, a capacity of the organization’s and the individuals’ within the

organizations are crucial to achieve corporate goals. Therefore, for the purpose of examining the administrative capacity ERCA in general, Kality Customs Branch Office in particular and EIC, the respondent asked the question ‘do you believe that investment incentive legislations have taken in to account the administrative capacity of ERCA?’ Accordingly, more than half of the respondents agree that administrative capacity of ERCA did not be taken into account in designing incentive programs. It was found that, this non consideration can be demonstrated by lack of trained and experienced work force. In addition to this, concerning experts, the data from interview with officials of Kality Customs Branch Office shows that, there is no institutionally or formally responsible body to examine goods and materials imported for investment purpose through incentive scheme.

To summarize, the incentive system of the country did not taken in to account the administrative capacity of administrative body. That is, ERCA lacks the administrative capacity to administer investment incentive. That is the institution does not have sufficiently trained and experienced human power that can improve the administration capacity. Though they are not the only factors, the main factors that affect the administrative capacity are also discussed as follows.

Table 4.4: Factors Affecting Administrative Capacity

Challenges	Frequency		%	
	Yes	No	Yes	No
Complexity of laws and regulations	70	26	73.2	26.8
Complexity of administrative procedure	56	40	58.8	41.2
Lack of capacity of staff to administer incentives	50	46	51.5	48.5
Interference from other government institutions	57	39	59.8	40.2
Interference from top and middle level management	35	61	37.1	62.9
Lack of attention for the administration of incentives	41	55	43.3	56.7
Complexity nature of incentives	51	45	52.6	47.4
Lack of expertise	49	47	51.5	49.5

Source: Compiled from the questionnaire, 2017

As indicated in the table 4.4 above, the respondents have given various alternatives and space in case if there is unidentified challenge(s). It appears from the table that, complexity of laws and regulations holds the first place as a challenge in the administration. That is, 73.2% of the respondents agree that complexity of laws and regulations is the major challenge of the incentive administration. Next to this, interference from other government institutions which constitutes 59.8% of the responses contributes a lot to the difficulty of the administration of investment incentives. 58.8% of the respondents also agree that, complexity of administrative procedure also affects the administration of incentives. This is almost in similar level with interference from other government institutions. More than half (51.5%) of the respondents also identified incapability of staff to administer incentives and lack of expert as the major challenges of administration of incentives. But, insufficient attention to the administration of incentive and intervention of the top and middle level management of the organization are identified by 43.3 % and 37.1% of the respondents.

Based on the above analysis; complexity of laws and regulations, interference from other government organs, complexity of administrative procedure, incapability of staff to administer, lack of experts and intervention from top and middle level management are the major challenges in the administration of investment incentives in their order of seriousness.

4.4 The Opportunity Cost (Revenue Forgone) of Tax Incentives in Ethiopia

The overall objective of the investment policy of the Ethiopian government is designed to improve the living standards of the people, enhance economic growth and thereby increase the productivity of revenue (Proclamation No.769/2102). Even though, providing duty and tax incentives for investors and business community in the short run has negative impact on revenue productivity, in the long run it has positive impact in increasing revenue productivity as well as sustainable economic growth.

Cost of revenue is one of the costs among others incurred due to tax incentives. During the study periods a total of around 244 billion birr tax incentives were granted to eligible beneficiaries. In the fiscal year 2006/2007, a total amount of Birr 3.6 billion duties and taxes were exempted as incentive and this amount increased from year to year and finally reached to Birr 66 billion in the

2015/2016 fiscal year. In general, the tax incentive amount granted by the government during the study period shown an annual average growth rate of 40%.

The highest percentage growth rate was recorded in the fiscal years 2007/08 – 2008/09 and the growth was about 95.1%. During this period, investment is/was highly encouraged by the government. The amount of tax incentives granted continues to increase year after year until 2015/2016 but there are ups and downs and the minimum annual growth rate which was about 15% percent was recorded in between 2010/11 and 2011/12. Generally, the sharp increase for the tax incentives is probably an indicator of higher number new investments made by domestic and foreign investors during the research period.

Table 4.5: The Amount of Tax Incentives, Total Government Revenues from Domestic Sources and GDP for Years 2006/07 – 2015/16 in Million Birr

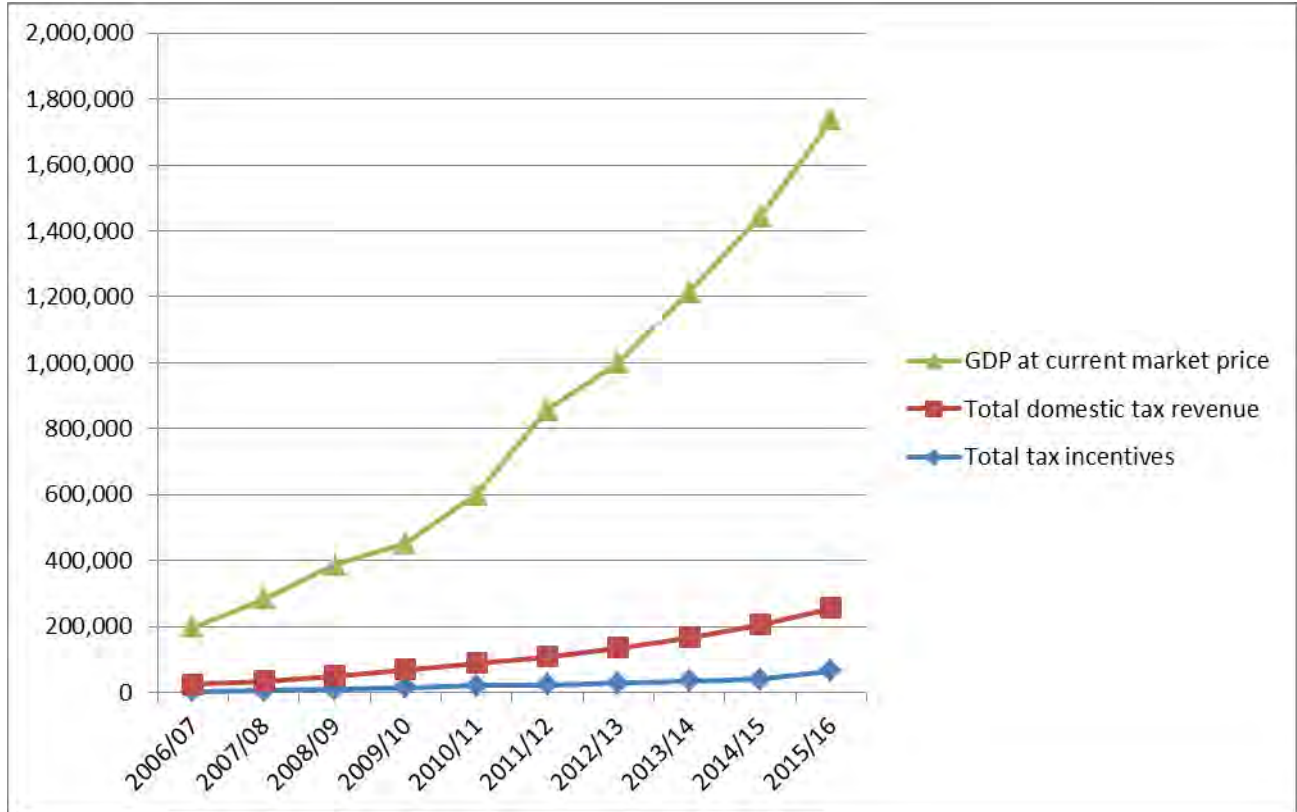
Year	Total tax incentives	Total domestic tax revenue	GDP at current market price	Tax incentive growth/yr.	Percentage of tax incentives to domestic tax revenue	Percentage of tax incentives to GDP	Percentage of domestic tax revenue to GDP
2006/07	3,563	21,797	171,989	-	16.34	2.07	13
2007/08	4,919	29,791	248,303	1,356(38%)	18.3	2.20	12
2008/09	9,716	40,184	335,392	4,797(96%)	26.46	3.17	12
2009/10	14,935	53,864	382,939	5,219(54%)	25.44	3.58	14
2010/11	19,925	69,120	511,157	4,990(33%)	22.07	2.99	14
2011/12	22,980	85,740	747,326	3,055(15%)	26.2	3.8	11.5
2012/13	28,506	107,010	864,673	5,526(24%)	26.6	3.9	12.4
2013/14	33,492	133,118	1,047,393	4,986(17%)	25.2	3.9	12.7
2014/15	40,542	165,277	1,236,678	7,050(21%)	24.5	5.3	13.4
2015/16	65,536	190,520	1,480,303	24,994(62%)	34.4	4.8	12.9
Average	244	896	7,026	6,886(40%)	24.6	3.6	12.8

Sources: - Own Classification and Computation Based on the Data from ERCA and MoFEC

The amount of tax incentives as a percentage of total domestic tax revenue collection was around 16 percent at the beginning of the study period and reached around 34.4 percent at the end which is almost half times from the starting percentage amount. When we see the general trend, it has shown an increase in all the study periods. The annual average share of tax incentives to total domestic government revenue was about 24.6 percent. The tax incentives to GDP percentage for the fiscal year 2006/2007 was about 2.07 percent and this amount reached around 4.8 percent on 2015/2016 fiscal year. The general trend of tax incentive to GDP percentage shows an increase

from year to year and the average rate was about 3.6 percent. This increment of tax incentive to GDP have big role for the increase of foreign direct investment, employment opportunity , productivity and move us from agricultural based economy to industry.

Fig. 4.1: Total Domestic Tax Revenues, GDP and Tax Incentives 2006/07 – 2015/16



Sources: Own Classification and Computation Based on the Sources from ERCA’s ASYCUDA Database and MoFEC

As we can observe from the above graph both the domestic tax revenues and GDP are increasing from the years 2006/2007 to 2015/2016 and this shows the economy is moving well.

The domestic tax revenue collection capacity of ERCA is increasing from time to time, and this was resulted in an increase of total domestic expenditure coverage by own revenue. In 2015/16; the ratio of total revenue to total expenditure has reached around 83% according to the data form MoFEC (see Figure 4.1).

When we compare the GDP of Ethiopia with Sub Saharan African (SSA) countries it is the 8th among the 53 countries included in the SSA nations. According to IMF (Oct, 2016) data the

country has recorded 67.435 billion USD. This amount shows there is promising economic growth in the country and it puts the nation's economy above Kenya (9th) and Tanzania (10th).

The revenue forgone as a tax incentive is a cost to the government it obliges to find other means of financing. As the evidence in the table below indicates, government grants huge amount of revenue as a tax incentive to the eligible beneficiaries when compared to the amount of indirect revenue collected by ERCA.

Table 4.6: Revenue Collected from Indirect Taxes 2006/2007 up to 2016/2017
(In Million Birr)

Revenue source	2006/07	2007/08	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Domestic indirect Taxes	3997	5,092	7,325	10,727	15,705	23,326	32,440	40,499	52,339	55,953
Import Duties and Taxes	6587	8,189	11,693	11,814	17,685	33,556	38,177	45,599	52,790	62,723
Tax Incentives	3563	4,918.8	9,716	14,935	19,924.85	22,980.3	28,506.3	33,491.7	40,542.3	65,536.3
Percentage of Tax Incentives to Import duty and Taxes	54	60	83	126	112.7	68.5	74.7	73.4	76.8	104.5

Sources: Own Computation Based on Sources from ERCA's ASYCUDA Database and MoFEC.

The secondary data gathered from Macro-Economic and Policy Management Section of Ministry of Finance and Economic Cooperation (MoFEC) and ERCA, shows that, during the period 2007/2008 up to 2015/2016 Customs collected 247 and 289 billion birr from domestic indirect taxes and import duties and taxes respectively. During this period, when we compare the tax incentive amounts with the collected indirect tax revenue amount, it weights around 98.8%. This indicates almost the tax incentive amount was near to the collected amount; and it shows that ERCA collects indirect tax revenue almost only half of the total amount that needs to be collected from domestic sources and from the imported goods. Particularly during 2008/09, 2009/10, 2010/11 and 2015/16 the tax incentive amount was more than the indirect revenue collected (Table 4.5).

The data from the above source also shows that, revenue generated from own sources take the major share of government financing. From the total government revenue for the period 2006/2007 up to

2015/2016, the share of tax revenue is 83% for the given period, others grants and borrowing have their own share. The public goods and services provided by the government are covered by these sources, then while the government forgone revenue for some purposes it requires to shift to other financing sources to fulfill its obligation. Government obliged to find grants or borrowings unless it designs other means of tax revenue like diversifying tax base or increasing tax rate or find other non-tax revenue source.

The amount of tax incentives granted during the study period is a significant amount and could increase the government revenue and reduce the financial resource gap. If the government had not been granted the tax incentives and it had collected, the possible change occur on the country's budget deficit is shown below.

Table 4.7: Illustration of Possible Changes on the Budget Deficit from 2006/2007-2015/2016 (In Million Birr)

Year	Total Revenue & Grants	Tax Revenue	Total Expenditure	Grants	Overall Budget Deficit including grants	Tax Incentives	Deficit can be reduced	
							By	To
2006/07	29381	17354	35563	7583	18209	3,563	20%	14646
2007/08	39705	23801	46915	9911	23114	4,918.80	22%	17960
2008/09	54637	29007	57775	14454	28768	9,716	37%	18135
2009/10	66240	43318	72598	12376	29280	14,935.05	47%	15576
2010/11	85611	58981	93943	16491	34962	19,924.85	44%	19701
2011/12	115,659	85,740	124,417	12,795	8758	22,980.26	262%	-14222(surplus)
2012/13	137,192	107,010	154,009	13,115	16816	28,506.33	170%	-11690(surplus)
2013/14	158,077	133,118	185,472	11,904	27395	33,491.71	122%	-6097(surplus)
2014/15	199,609	165,277	224,881	13,020	25272	40,542.27	160%	-15270(surplus)
2015/16	244,804	190,520	279,164	13,014	34360	65,536.34	191%	-31176(surplus)

Source: Own Compilation Based on Sources from Macro Economic Policy and Management (MoFEC), and ERCA's ASYCUDA Database for the Revenue Forgone.

*The forgone revenue amounts represent only Customs duty and other import taxes.

In the above table 4.7 the researcher tries to show that to what extent the budget deficit can be decrease; even show surplus if the tax incentives amount had not been lost to those entitled beneficiaries. During the given period (2006/2007-2015/2016) the revenue forgone and budget deficit amount reflects that it increases from time to time. If the government collects customs duty and other import taxes from all imported goods without offering duty exemptions, deductions or exclusions; the country's budget deficit will be minimized or reduced as indicated in the table above.

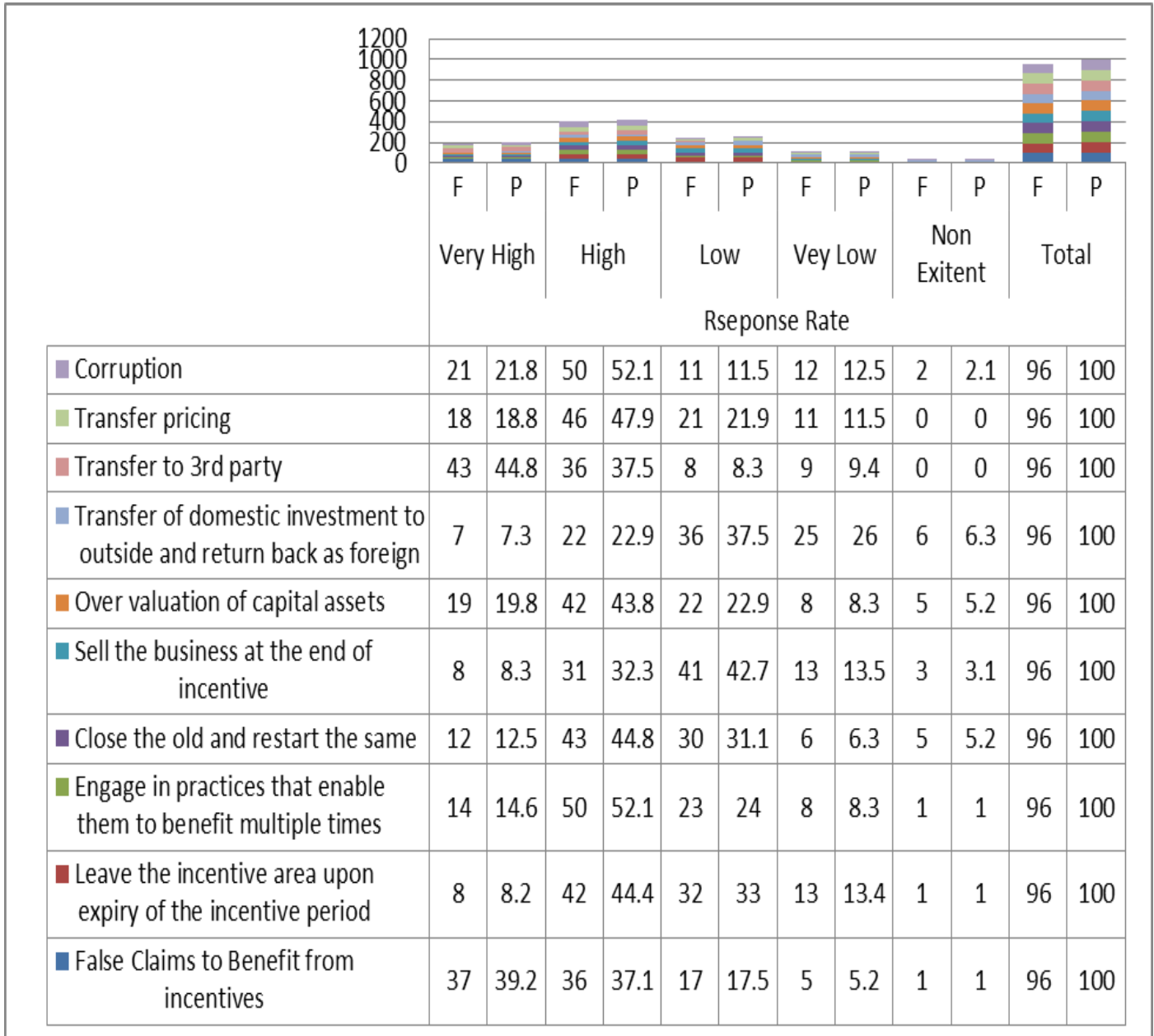
The data on the table shows that there is a high percentage possibility to improve the negative balance of the budget. Starting from year 2006/2007 up to 2015/2015 on average about 108% of budget deficit had been covered from the revenue granted as tax incentives; especially this amount reached its maximum of 262% during 2011/2012. This implies that the country is losing significant amount of revenue from granting tax incentives. On the other hand, loss of this amount has a big meaning to the nation suffering with high domestic and foreign borrowings and characterized by low tax to GDP ratio.

The tax to GDP ratio measures the countries capacity of utilizing own sources. According to the data obtained from Macro Economic policy and Management section of MoFEC, presented on the Table 4.5, the tax to GDP ratio in Ethiopia increases up to year 2010/2011, between & after that it decreases for three years and again it starts to rise in the year. But when we examine the tax to GDP ratio of some Sub-Saharan African countries based on the data from World Bank (2016); Ethiopia's tax to GDP ratio is much less than the SSA countries and this implies that the tax revenue in the country is minimum. If the forgone amount had been collected the share of tax to GDP can rise to some extent. For example the tax to GDP can rise to 15.3% in 2011/2012, 16.3% in 2012/13, 16.6% in 2013/14, 18.7% in year 2014/2015 and 17.7% in 2015/2016 (see Table 4.5).

4.5 Techniques to Abuse Investment Incentives

Before turning to the discussion of the techniques to abuse investment incentives in Ethiopia, it's reasonable to briefly examine what are considered as abuse or misuses of incentives in laws and the measure that would follow. Abuses or misuse of incentives for the purpose of this study is using incentives privileges in contrary to investment laws, tax and customs laws and other relevant laws regulating incentives. In other words, abuse of incentives can be said using any incentive (privilege) for the purpose other than it is granted for. According to article 19 sub article 2 (b) of the proclamation No. 769/2012, misuse or illegal transfer of the incentives granted for investment purpose can be resulted in the revocation of the investment permit. It might also be resulted in both criminal and administrative penalties.

Figure 4.2: Response on Techniques to Abuse Investment Incentives



Source: Compiled from the questionnaire, 2017

As can be seen figure 4.2 above; the majority of respondents related that false claim to be benefited from incentives is very high and high; (39.2%) and high (37.1%) respectively. Only 17.5% of the respondent’s rate is occurrence as low. An insignificant number of respondents rate it as a very low (5.2%) and nonexistent at all (1%). This indicates that, there is a high degree occurrence of false claim to be benefited from incentive scheme. In this regard, though it was

difficult to have complete data, some crime investigation records show that, there are investors who became beneficiaries of incentive schemes and attempted to import goods by using false letters of permission. Concerning this, when the researcher deals with officers of tax and customs fraud investigation directorate and investigative audit; it was found that an investor provided false information and became beneficiary of the investment incentives. During the discussion it was found that there is a case which the investor provided documents that who engaged in the manufacturing industry to produce blanket and comfort. Accordingly, she/he exempted from income tax for two consecutive years (2002-2003 Ethiopian fiscal years) and customs duty for the goods and materials necessary for the said investment which worth 6,745,349.60 (six million seven hundred forty five thousand three hundred forty nine birr and 60 cents). However, when it investigated by the ERCA'S investigative audit, the investor had been importing already finished blankets and distributes it to the market in which case, no incentive would be granted. Thus, this is also another indicator of that there are investors who benefit from the incentive system illegally.

Moreover, the assessment report prepared by the committee established at head office level of ERCA for the purpose of conducting assessment on the investments beneficiaries from incentive schemes and their implementations. It shows that, the government has forgone 10,201,043.47 (ten million two hundred one thousand forty three birr and 47 cents) from only three investment projects due to false investment license and incentive on the basis of these false license. This indicates that, if all projects which are benefited from incentives had been examined, there could be found that many investors have been used by using false license or letter of approval.

According to interview conducted with one officials of Addis Ababa Kality Customs Branch Office, there are investors who became beneficiaries by using fictitious investment documents. An interviewee has cited two prominent cases: one , there was a case that an investor claim and granted around 100 million birr customs duty exemption to establish metal industry in Dukam and Wollo. However, it was found fictitious investment and the investor sold the goods and materials in the local market. In cases like this, it was mentioned that the major challenges of controlling and detecting such practices is the lack of information which is caused due to the lack of coordination and information exchange between different organs. This findings is supported record keeping is among causes of administrative difficulty. In the same way, there was a person

who was living in Europe (absentee investor) and granted the customs duty exception of more than 84 million birr without having any investment in Ethiopia. Therefore, this reveals as there are risk factors that investors could use incentives privileges illegally. There are several possible explanations for this result. But the most important thing is that, the country is losing huge amount of money without having anything to get back under disguise of investment promotion.

In the case of Leave the incentive area upon expiry of the incentive period; 44.4% of the respondents rated the occurrence of those investors leave the incentive area upon the expiry of incentive period is high. But as compared to false claim, a significant amount of the respondents (33%) rated its occurrence low. Nonetheless, the rate of very low and non-existence is 13.4 % and 1% respectively. It's understandable that, this type of abuse relates to tax holiday. During a tax incentive period those privileged firms taxed at a lower rate than the normal tax rate. This nature of the privilege provides certain firms to take advantage in a given period and leave the incentive area in the expiry of the period. This way of abuse is common in different countries. For example, it has been found that, manufacturer of computer microprocessors, which enjoyed an eight-year tax holiday in an Asian developing country packed up and set up a new operation in a neighboring country which offered a new tax holiday at the end of the tax holiday (UNCTAD, 2009. 25). Whilst it is generally agreed that, tax holiday is easy to administer, unless the administrative body has strong capacity to administer, it creates the opportunity for the illegal investors to exploit the country's revenue. For this reason, the beneficiaries' activities need regular scrutiny by the administrative body (tax authority). Especially, when the period provided goes to end, strict monitoring has to be implemented.

With regard to engage in practices that enable them to benefit multiple times; more than half of respondents (52.1%) rates the occurrence of investors engage in practice that enable them to benefit multiple times is high. Only a small number (24%) rate its occurrence low. This result has close relation with the result shown under figure 2, no.9 above. To put it another way, those who leave the activities that enable them to be beneficiaries for multiple times in different name or nature of business in the same country or move to another country with the same investment. However, more than third (33%) of those surveyed indicated that moving to another country be closed the operation in order to benefit from incentive is low. This might enable us to conclude that more investors prefer to come up with investments which enable them to benefit multiple

times than moving to another country. On the other hand, nearly one third (44.4%) also demonstrated that it is high. Another 10.3% said its occurrence is very high. 8.2% indicated that it's very low and remaining 1% felt that it's non-existent. In this case; there are no clear penalties that are participated in this abuse technique. So investor's activities should be closely monitored specially at the end of their incentive periods.

In the case of close the old and restart the same to be benefited from incentive; most of those surveyed (57.3%) indicated that investors close their old investment and restart the same to be benefited from incentive. Similarly, a significant number (31.1%) of the respondents rate its occurrence as low. This finding is consistent with the committee's report, which showed that, there are investors who benefited from the investment incentives and close their investment at the end of the incentive period ,specially ,the tax holiday period. This implies, when an investor want to close the investment and require clearance, there should be strong coordination and information exchange between clearance authority and tax authority. Moreover, there should also information network with the society. The society, who lives around the investment area, could have better information about the activity of the business than anyone else.

Regarding its occurrence of that investors sell their business at the end of the incentive period; the majority of the respondents (42.7%) rated the occurrence that investors sell their business at the end of the incentive period is low. At the same time, nearly one third (32.3%) of the respondents rated it high. Another 8.3%, 13.5% and 3.1% rate it as very high, very low and non-existent respectively. Since this problem is more related with tax holiday than other types of incentives, the interview has been conducted with higher official of ERCA. The data from the interview indicate that, there is no clearly identified responsible body to handle tax holiday implementation issues.

Concerning the occurrence of overvaluation in order to benefit from incentives; 43.8% of the respondents rated that the occurrence of overvaluation in order to benefit from incentives is high. Another 19.8% also said that it's very high. Only a small number (22.9%) of the respondents demonstrated that it's low. The reason for this might be that, the minimum capital requirements for foreign investors. According to article 11 of the investment proclamation no. 769/12, any foreign investor should satisfy the minimum amount of capital stated. The amount depends on

the type of investment and/or ownership of the investment. For example, any investor who wants to invest in areas other than architectural or engineering works or related technical consultancy services, technical testing and analysis or in publishing work (<http://www.ethiopiaemb.org.cn/invest-4htm>) shall allocate a minimum of two hundred thousand (200,000) USD for a single investment. However, if it is jointly with a domestic investor, the minimum capital would be 150,000USD (<http://www.2merkato.com/articles/investment/18-investment-regulations-in-ethiopia>). Similarly, the investment in architectural or engineering works or related technical consultancy services, technical testing and analysis or in publishing the minimum capital would be one hundred thousand (100,000) USD. If it's made jointly with a domestic investor, the minimum capital would be fifty thousand (50,000) USD. Thus, it's not surprising that if some dishonest investors try to over value their capital in order to reach on the stated minimum amount and to benefit from incentive privilege.

Transfer of domestic investment to outside and return it back as a foreign investment is one of the methods of abusing investment incentives. Thus, regarding its occurrence in Ethiopia, figure 4.2 above represent that, greater part of those surveyed respond that it's low (37.5%) and very low (26%). Only a medium number (22.9%) said its occurrence is high. And also only an insignificant amount felt that it's very high and non-existent that each rated 7.3 & 6.3% respectively. This problem is common, when the privilege focuses on foreign investors and discriminates domestic investors. In this case, domestic investors prefer to transfer the domestic investment and return it back as a foreign investor. However, as a result shows above, this problem is rated as low in Ethiopia. The probable reason for this is most of the investments in Ethiopia are not reserved for foreigners. Because, this problem would probably occurs if there is special treatment and privilege for foreign investment to domestic investment. This finding corroborates the ideas of Bereket (2014), who expressed that round tripping is not a problem in Ethiopia because most of the tax incentive regimes are not geared particularly towards foreign investors. Rather, domestic investors have a better opportunity than foreigners.

Transfer of the goods and/or materials acquired through the incentive privilege to the person who do not have the same right is one of the abuses of investment incentives. This problem is common when goods and materials acquired through duty free. Transfer could be made by sell, mortgage, donation, inheritance or any other means. Hence, regarding this issue the data

presented in the figure 4.2 above represents that, its occurrence is very high. That is the majority of the respondents felt that it is very high and high; cover 44.8% and 37.5% of the respondents respectively. Only an insignificant amount of the respondents which is 8.3% and 9.4% said it's low and very low respectively. This reveals that, there is a high rate of transfer of goods and materials acquired under incentive scheme. According to reports collected from the tax and customs frauds investigations directorate of ERCA, in 2004 Ethiopia fiscal year, 51 investigation files were investigated on transfer of incentives through different means including sell, donation, rent, and keeping idle. Similarly, though the report is not complete, in 2005 Ethiopian fiscal year, 45 investigations have been held in all investigation departments. In 2006 Ethiopian fiscal year, there were 52 investigation cases conducted against the fraud transfer of goods and materials acquired through duty free privilege. The possible explanation for this result is considerable amount incentive privileges have been transferred to third party. This suggests us, unless strong monitoring and controlling system has been implemented, investors use goods and/or materials from unintended purposes. The data from the interview with law enforcement officials and officers show that, since the major source of Enforcement is information. But due to weak information exchange between concerning bodies, it's hard to find information on other types of abuses. In the same token, data from interview indicate that, both ERCA and EIA are reluctant in the enforcement incentive privilege.

Transfer pricing is to think of transfer pricing as a phenomenon that occurs internationally in transactions between related enterprises in different countries. Transfer pricing can also take place in a single country where an investor has two or more operations within a country or where the investor derives income from more than one activity. If one of those operations, or one type of income, enjoys a tax preference, profits will tend to be allocated to the preferred activity (Easson and Zolt, 2002). Thus, it is apparent from figure 4.2 that, large number (47.9%) of respondents felt that its occurrence is high, 18.8% also though its occurrence is very high. Those felt that its occurrence is low (21.9%) or very low (11.5%) are small in number. The problem of transfer pricing associates with tax holiday and it would be committed between multinational companies such as construction companies; textile, Electronic, Car fabrication and assembling industries are same of involved in this kind of fraud. The reason is that if it's within one country, there would not have an effect on the tax burden of the companies. The result indicates that, there is a high degree of transfer pricing in Ethiopia. This finding is in agreement with Bereket's

(2014) findings, which showed the existence of transfer pricing and its difficulty to administer. According to him, the application of the transfer pricing rules is hampered in Ethiopia by the lack of adequate administrative resources (especially in the audit departments). The data from the interview also show that transfer pricing seems does not given priority in the administration. One of the indicators of not giving necessary consideration in the administration is it was hard to find relevant data regarding transfer pricing. However, the research finding by Tekalign (2014) shows there are risk factors that indicate the occurrence of the transfer pricing that is, according to OECD (2013,p.20) year loss making where there is no attempt made to change business operation of financing is one of the risk indicators of transfer pricing. Sustained losses may be evidence that the reported results do not reflect the true value of the business. Hence, to examine the risk of occurrence of the transfer pricing in Ethiopian, data about 61 multi-national companies' business performance which was collected Tekalign (2014) and annexed in the paper is used. The data was five consecutive years' (from 2008 to 2012) performance of the company. As the data indicate, 42.6% of the companies declare loss persistently. Among which 32.5% of the companies declare at least for four consecutive years. Surprisingly, 26% of the examined companies were declared loss for the whole five consecutive years. Therefore, as one can easily conclude from the data, this is not healthy way doing business. Because, as it's obviously known the primary motive of any business company is making profit. When any company incur loss on year to year, it's expected to take appropriate measure including closing the business. Thus, the possible conclusion which can be inferred from the above data is, there are risk indicators of transfer pricing in Ethiopia.

The granting of tax incentives, especially where the process involves a substantial degree of discretion, is one situation where there is a strong risk of corruption (Easson and Zolt, 2002)

The respondents were asked to rate the occurrence of corruption in the process of incentive implementation. As it is apparent from the figure 4.2 above, the level of corruption in the implementation of investment incentive is high. That is, as shown in table above, 52.1% and 21.8 % felt that corruption is high and very high in the implementation of investment incentive respectively. Very few respondents thought that corruption is low (11.5%) and very low (12.5%). Corruption is one of those challenges that affect the incentive system. Consequently, the committee was suggested that , for there is involvement of different government bodies and employees (both internal and external) in the process of permission of incentives and its abuses,

the federal ethics and anti-corruption commission has to intervene in the controlling process. An interview with law enforcement officials shows, the activities such as determining the amount or quality of goods and materials necessary for a certain investment, issuing a letter of commencement of the a certain investment which make eligible investors for tax holiday ,examining the proper use of those privileges are prevalent areas for corruption. This tells us that, corruption in relation to investment incentives is not the only problem of ERCA. Rather it could extend to organization/individuals directly or indirectly involving in the incentives tasks. In this regard the data from interview indicate that no way to conduct cross check on the engineers who prepare bill of loading. It is also found that there are some irresponsible individuals who prepare documents for illegal investors who then become eligible for the incentives.

In general, the findings regarding the techniques of abusing /misusing of investment incentives can be summarized as follows. There are occurrences or at least there are indicators of the occurrence of techniques of abuses of incentives. That is ,false claim and factious investment to benefit from incentive system; leaving the incentive area upon the expiry of incentive period; engaging in practices that enable them multiple times; selling the business at the end of incentive period; overvaluation of assets in order to satisfy the minimum capital requirement, transferring goods and materials acquired through incentive privilege to third party, transfer pricing to reduce or avoid tax burden and corruption is among challenges identified. However, ERCA does not have system to full monitor and control these serious problems. There is no responsible body which monitors and controls its proper implementation. There is also no proper data enable to know even the period granted and the period of commencement and expiry particularly in case of tax holiday.

4.6 Legal Framework of Tax Incentive in Ethiopia

Investment incentive is one of the policy tools to achieve the investment policy of the country. Thus, any policy implementation should be based on the chapter ten of the 1995 FDRE constitution. According to article 89 sub article 1 and 2 of the constitution, the government's economy policy should ensure the benefits of the Ethiopia people and equitable distribution of wealth among themselves. Thus, the incentive program is also expected to achieve this economic goal in the way that ensures the benefits of the people and equitable resource distribution.

In Ethiopia, the basic legislative instruments for the promotion of private investments (both foreign and domestic) are the 1995 FDRE constitution, investment proclamation No. 769/12 and council of ministers regulation No. 270/12. The regulation provides the basic mechanisms by which the private investors claim incentives. In simple terms, investors that fall under the regulation No.270/2012, and which fulfill the conditions determined by it, can apply to the respective authority and receive considerable incentives from the state. So, they can start or further expand their investment activities in Ethiopia. Therefore, laws and regulations for the implementation and administration of the incentives schemes are expected to be self-sufficient tools. As a result, data regarding, clarity, understandability and adequacy of existing laws and regulations have been analyzed and interpreted as below:

NB: SDA=strongly disagree, DA=disagree, NN=neither agree nor disagree, A=agree, SA=strongly agree

Table 4.8: Nature of existed laws

Existing laws & regulations	Response Rate									
	SDA		DA		NN		A		SA	
	F	%	F	%	F	%	F	%	F	%
Sufficient for administration of incentives	5	5.2	51	52.6	14	14.4	25	25.8	1	1
Clearly of state the powers & responsibilities of concerning bodies	51	52.6	22	22.7	21	21.6	38	39.2	1	1
Clear & understandable for implementation	19	19.6	46	47.4	11	11.3	17	17.5	7	7.2
Clearly sate penalties & administrative measures	16	16.5	17	17.5	18	18.6	36	37.1	9	9.3
Clear & understandable to beneficiaries	12	12.4	38	39.2	19	19.6	22	22.7	6	6.2
Coordinated with administrative framework	20	21.6	41	42.3	21	21.6	24	24.7	4	4.1

Source: Compiled from the questionnaire, 2017

Table 4.8 above indicates that, more than half of the respondents (52.6%) disagree with the statement that laws are sufficient enough for the proper administration of investment incentives. Among those disagreed, some support their opinion by exemplifying that, most of the incentives claimed for agricultural and mining investments could not be found in existing laws and regulations. But, in practice they have been granted by different letters. This indicates that, there are incentives which are not incorporated in existing laws, but practically implemented by other means. Thus, the study tells us that, the government has no sufficient laws and regulations which incorporate all incentives and enable the administrative body to administer it appropriately.

Regarding its clarity in stating powers and responsibilities of government institutions involving in the implementation of investment incentives; more than half (52.6%) of the respondents strongly disagree that the existing laws state powers and responsibilities of the concerning bodies. The responses from the interview also reveal that, it's hard to clearly know who should do what regarding incentives especially after it has been permitted. One interviewee concludes that, the issue of administration of investment incentives lacks clearly responsible owner. Moreover, when the researcher deals with the concerning bodies of EIA and ERCA about the reports regarding implementation of investment incentives, there was responsibility shift from one to another. Thus, this indicates that, the powers and responsibilities of concerning bodies regarding the administration of investment incentives are not clearly provided in laws.

Concerning the clarity and understandability of the existing laws for the implementation and to comply with, nearly half (47.4%) of the respondents disagree with its clarity and understandability. Thus, this result indicates that, existing laws and regulations; lack clarity and understandability to both implementation and to comply with (beneficiaries). This finding further supports the finding of the research and development directorate of ERCA which showed a legal framework lacks clarity which creates loopholes for the misuse of the incentives and administrative difficulty. Some of the respondents raised article 13 sub-articles 1 of the regulation No. 270/2012 as an example of its non-clarity of regulation. This specific provision entitles any investor to import duty free capital goods and construction materials necessary for the establishment of new enterprise or expansion or upgrading of existing enterprises provided that in the investment areas not excluded by the same regulation.

Similarly, though article 2 sub-articles 8 of the proclamation No. 769/2012 defines expansion and upgrading of existing enterprises, the provision remains subject to different interpretations. The best indicator of its non-clarity is a case by case basis interpretation given by the officials letter (Ref No.□□/22/05) written to ERCA by EIA on the date 2/4/2013. For instance, if level one contractor wants to upgrade to the level two, the letter allows duty free import goods and materials necessary for the latter level regardless of other tests.

Unlike its non-clarity and understandability for implementation and beneficiaries, more than one third (37.1%) of the respondents agree that the law is clear in stating penalties and administrative measures in case of abuses. However, while the researcher deals with some tax and customs frauds investigation officials, it was expressed that, the existing laws do not have sufficiently clear provisions which deal with penalties to be imposed and measures to be taken in cases of each type of abuse. Similarly, from interview with law enforcement process unit of the Kality Customs Branch office, it has been found that, subjective decision are the result of the lack of clearly stated penalties and measures.

This finding is in agreement with Bereket's (2014) finding which showed ERCA has a variety of sanctions at its disposal for penalizing non-compliance, ranging from relatively normal monetary penalties to criminal prosecutions. But, ERCA has been quite lenient in pursuing offenders and in imposing penalties. Nevertheless, article 2 sub article 53 and art 163 of the current Customs Proclamation No. 859/14 exclude misuse of duty free goods from criminal liability. It's also clearly seen in the table that, clarity and understandability of the existing laws and regulations are disagreed by the 39.2% of the respondents. Likewise, its coordination with the administration procedures is also disagreed by 42.3% of the respondents. Thus the result reveals that, beneficiaries do not know the extent of their right and responsibilities which emanate from their privileges. It also indicates that, they lack coordination with administrative procedure.

Table 4.9: Appropriate institution (s) to administer investment incentives

Appropriate Institutions	Response	
	Frequency	Percentage
Both ERCA and EIA	65	67.7
Only ERCA	19	19.8
Only EIA	10	10.4
MoFEC	2	2.1
Total	96	100

Source: Compiled from the questionnaire.2017

As can be seen from the response to a question about the appropriate organ to administer investment incentives in the table 4.9 above, 68 % of the respondents support the administration should be held by both ERCA and EIA jointly. Some of those supported this jointly administration tried to justify their opinion in that, administration of investment incentives is not merely the issue of either investment or tax ,rather the combination of these two wide concepts . Therefore, since ERCA and EIA have their own experts and resources to administer tax and investment respectively, both should administer their respective parts of the investment incentives. However, the research conducted by James (2009) has suggested that, only the tax administration should administer tax incentives. Moreover, as it’s shown in the table 4.8 above, the power and responsibilities of these two institutions are not clearly indicated in incentives laws and regulations. That is, in the absence clearly stated powers and duties of these administrative organs, effective administration is unthinkable. On the other hand, some respondents also support separate administration by either organ. Accordingly, 19.8% of the respondents support the administration should be held by the Ethiopian Investment Agency (EIA). Another 10.4% of the respondents support that it should be held by Ethiopia Revenue and Customs Authority (ERCA).

In general, the current administrations of the investment incentives have been performed by both ERCA and EIA. However, though the administration is assigned to both institutions, it’s not clearly known what specific tasks each organization should perform. As a result, there is no strong administration of incentives system, particularly after it has been permitted. This does not

mean that nothing is stated in the laws regarding investment incentives. Rather, there are tasks which are not practically assigned to either of the institutions. Unless each institution knows its power and responsibility, it complicates the administration, facilities abuses, encourage corruption. The responsible body for every task should be clearly known. Such non clarity may produce inefficiency and duplication of tasks.

Even though the administration of the incentives is assigned to EIA and ERCA, both federal and regional governments provide a variety of incentives. At the federal level, for example, a number of ministers and government bodies like Ministry of Agriculture, Ministry of Mining and Ministry of Finance and Economic Cooperation and others provide incentives by subsidies pieces of legislations. In the same way, regional states provide incentives applicable within their respective jurisdiction. Thus, in order to achieve the economic goal of the county through encouraging investment by providing incentives, institutions involving in the investment incentives implementation should be coordinated. For the purpose of this study, coordination includes, sharing of information, resources, knowledge and experts and responsibilities to ensure proper implementation of incentives. Thus, since coordination is one of the key components of administration, data regarding coordination between ERCA and other concerning bodies has been analyzed as follows.

NB: F=Frequency, VP=Very poor, VG=Very Good

Table 4.10: Coordination between ERCA, EIA and other concerning bodies

Statements		Response				
		VP	Poor	Fair	Good	VG
Coordination between ERCA and EIA	F	15	28	21	30	2
	%	15.6	29.2	21.9	31.3	2.1
Coordination between ERCA and regional investment agencies	F	34	31	17	12	2
	%	35.4	32.3	17.7	12.5	2.1
Coordination between ERCA and Other government agencies	F	29	28	21	18	0
	%	30.2	29.2	21.9	18.8	0

Source: Compiled from questionnaire, 2017

It can be seen from the table 4.10 above that, 31.3% of the respondents rated the coordination Between ERCA and EIC is good. For 35.4% of the respondents, the coordination between ERCA and regional investment agencies is very poor, Similarly, 30.2% rated the Coordination between ERCA and other government agencies very poor, from this data we can see that coordination between ERCA and other concerning bodies is very low. Moreover, the result of the ERCA's committee (hereinafter the committee or the ERCA's committee) study substantiates the same thing that the Kality Customs Branch Office has the problem of working in coordination with others. Therefore, this result shows that, the central part of effective administration which is coordination is lost between ERCA and other administrative bodies. This in general can make the incentive administration inefficient.

So, in order to achieve the intended purpose, all the concerning bodies should be coordinated. Better coordination among concerning bodies can minimize unnecessary wastage of resources for the government in general and institutions involving in the administration in particulars. Besides, it avoids duplication of functions and enhances opportunities for institutions implementing related responsibilities to administer and resolve differences in procedure. This in turn, brings efficiency, effectiveness and better service delivery. It might help to reduce unnecessary work load of institutions primarily involving in the administration.

To recapitulate, the administration of investment incentives is assigned to Ethiopian Revenue and Customs Authority (ERCA) and Ethiopian Investment Agency (EIA). However, there are different institutions, both from federal and regional government institutions involving in the implantation of investment incentives. These institutions lack coordination with administrative bodies, particularly with ERCA. As a result ERCA faces shortage of information on administration and enforcement of incentive laws. Consequently, the administration of investment incentives in the country could be considered as weak.

4.7 Mechanisms to improve the effective administration of tax incentives

The effective incentive program needs effective administration. The properly designed incentive program would worth little if it's not implemented effectively. Three ingredients are essential to the effective incentive administration among other; political commitment, clear strategy and adequate resource allocation. Incentive administration tasks could be categorized in three major

activities: facilitation of the compliance, enforcement and improving the administrative procedure (Easson and Zolt, 2002).

Without a formal monitoring mechanism, investors have little reason to make realistic projections as to the number of jobs that will be created, or the volume of exports that will be produced (Easson and Zolt, 2002:54). Hence, as it's shown in literature review part, there are mechanisms to improve incentive administration. Such mechanisms include, requiring financial statements of related business and keeping incentive system simple. Thus, in order to examine appropriate mechanism to improve monitoring and controlling of the incentives, the respondents were asked the question what probable solution you propose in order to reduce the abuse of incentives and ensure its appropriate usage. Accordingly, the responses have been analyzed as follows.

Table 4.11: Mechanisms to control and monitoring investment incentives

Proposed Solutions	Response	
	Frequency	%
Strong Audit	77	80
Improving enforcement and monitoring capacity	79	82.3
Increasing penalty	61	63.5
Requiring financial statement of related business	41	42.7
Keeping incentive system simple	51	53.1

Source: Compiled from the questionnaire, 2017

From the data in table 4.11, it is apparent that on average more than half 60 % of the respondents propose that strong regular audit system, improved enforcement & monitoring capacity and increase penalty in case of abuse are solutions to reduce abuses of investment incentives.

As it's indicated in the table, large number of surveyed respondents proposes that strong audit system and improving enforcement and monitoring capacity of the administrative organ as solutions. These two options account 80% and 82.3% of the responses respectively. Similarly, more than half of the respondents (53.1%) also said, keeping the incentive system itself simple is

the solution. Simultaneously, more than one third of the respondents demonstrated increasing penalties and requiring financial statements of related business that constitutes 63.5% and 42.7% respectively are solutions.

The findings of this study suggest that effective incentive administration starts from its designing stage. That is, at this stage, the incentives system should be designed in a simple form. This starts by examining the purpose for which the incentive is needed. Then the appropriate types of incentive for the intended purpose have to be identified. However, incentive should be granted for the investment which could not be achieved unless incentive is granted. That is it should be the last resort. If there are another alternative it should not be necessary to implement it. It has to be simple for administration. That is to say; the system has to be easily accessible and straightforward to determine eligibility. However, as it's discussed above, Ethiopia incentives system is lacks simplicity to determine eligibility. It's subject to broad interpretation which might create loopholes for misuse of the privileges.

Another mechanism is strengthening the audit system (both tax and post clearance audit). Though these two concepts are interrelated, their concern is somewhat different. Tax audit concerns tax return to individuals and companies and determine the amount of tax to be paid. It examines inland revenues. In the sense of this study, it helps ERCA to administer tax holiday trough examining the company's investment activity during the incentive period. As it is indicated, most of the abuses related to tax holiday. These include, transfer pricing, closing the business, leaving incentive areas and selling the business. Thus, when the tax audit system is strong enough it enables the tax authority to reduce the occurrence of these problems. However, the data from the interview with the officials of the domestic tax branch support directorate of ERCA shows that the audit system is not strong enough in the administration of tax holiday. One of the reasons mentioned as a cause of weak audit system is lack interconnected information access. That is, lack of mechanism to know automatically, which is privileged, the period of commencement and expiry of tax holiday.

Similarly, post clearance audit (PCA) is one the mechanisms for the effective incentive administrations. Unlike to tax audit, it focuses on the examination of documents related with customs transaction including declarations, relevant books and commercial documents. That is, it examines the relevant documents of companies and individuals involved in international trade in

order to ensure their conformity with relevant laws and regulations. This shows, they can examine the documents of companies and individuals who import goods and materials through duty free scheme. Strong PCA enables the tax authority to reduce misuses of duty free goods and materials. ERCA has PCA departments both at head office level and branch offices level. As result, AAKCAO has also its own PCA work processing unit.

However, as the data from the interview from the head office indicate, the PCA department at head office level may not conduct documents unless information is provided to that effect. In contrary, the PCA at branch level has responsibility to conduct any relevant documents in order to ensure accuracy and conformity of those documents which relevant laws and regulations. This is to mean, it is duty bound to examine documents of companies and individuals who are exempted from payment customs duty for the investment purpose by different laws and regulations. However, while filling the question have you done any or related investment incentive, the majority of post clearance auditors indicated they do not have relevant experience. Similar of PCA at head office level, they also rely on information it does mean that no examination of documents would be conducted. This suggests that, PCA system is not strong enough to the administration of investment incentives. Therefore, there should be strong well equipped PCA system which should be supported by IT based data base.

It is important to acquire the financial statements of related business which enables the authority to reduce the occurrence of transfer pricing. Some companies and/or individuals use related business to reduce their tax burden by transferring their profiles to the business in the area of low tax burden. Then they might avoid tax by declaring loss. If there is requirement of providing financial statements of related business while providing investment incentives it would ease to identify the transfer of profit to those business. In Ethiopia, Such requirement is not applicable. However, according to art 29 of the income tax proclamation No.286/2002 the tax authority may direct that the income of one or more of those related persons to include profits which he or they would have made but for those conditions provided that those conditions make made or imposed financial relations of those related persons from independent persons. This implies it's not requirements rather exception when the condition requires. Therefore requirement of the financial statements of related business is not a requirement in granting incentives.

Another mechanism is improved law enforcement capacity. Law enforcement in this study includes but not limited to; a system of enforcing tax and customs laws by discovering, deterring, rehabilitating or punishing peoples who act in contrary to the provisions of those laws. To this end, ERCA has law enforcement at deputy director general level at the center and work process units at branch level. Though there are other departments; the major departments under laws enforcement are intelligence departments, fraud investigation departments, prosecutor departments, action department and investigative audit departments. This means, AAKCBO has these all departments under law enforcement work process unit. Nevertheless, during interview with some enforcement officials of the branch; it was indicated that the enforcement of incentives laws do not given necessary attention.

The task of enforcement is very recent phenomenon though the current incentive system exists for a decades. As the data from the interview indicates; the authority is almost lenient in enforcing incentive laws other than incentives granted to import vehicle in which case there is attempt to control. Some officials also said that misuse of incentive sometimes might not be considered as fraud. As the one officials of law enforcement of the branch office indicated, most of the enforcement activities rely on the information from different sources (both internally and externally). This needs coordination of different bodies from which relevant information would be collected. In the absence of coordination; the information exchange will be ineffective. This in turn weakens the enforcement capacity of the branch. That is in the absence of relevant data enforcement activities are lame. As discussed above, the findings of this study regarding coordination of concerning bodies shows weak coordination. As a result, the information exchange is also weak. This weakened the enforcement capacity. Therefore, the enforcement capacity of the branch should be improved.

The last mechanism for the purpose of this study but not the least is penalizing those beneficiaries act in contrary to laws. No one should benefit from his or her wrong act. Any wrong should be attached with appropriate penalty. Not only penalizing but also the penalty should have capacity of deterring the wrong doer and other potential wrong doers. That is it should be unpleasant to the doers in which case they might think twice before doing any wrong. However, article 2 sub article 53 and art 163 of the current customs proclamation No. 859/14 exclude misuse of duty free goods from criminal liability. According to this law; misuses of duty free privilege will be punishable administratively. They would be subject payment of the duty

and tax payable assuming that the goods are imported at the time of seizure, punishment with fine equivalent to 50% of the amount of such duty and tax. Here, the punishment is 50% of the duty and tax. Because, paying appropriate tax and duty could not be considered as punishment. It's duty of any importer unless the privileges had not been granted.

Therefore, the central question here is, could this punishment deter the wrong doers and other potential wrong doers in the absence of strong potential to be discovered. The reason is it is believable that those investors who would be eligible for incentive schemes are financially strong and who could run huge investments. Moreover, the data from the interview also shows no sufficient punishments have been imposed. Though different factors could be cited as the causes of its insufficiency, non-clarity of laws could be considered as the major cause. For example, there is one case which is cited above (blanket producer) in which case nobody took the responsibility to cancel tax holiday privilege even after the investor left the country. Therefore, it's possible to conclude that ERCA do not have sufficient penalty that could ensure appropriate use of incentives.

Thus, the finding indicates though some mechanism such as audit system (both tax and PCA) and law enforcement are applicable in ERCA; they are not strong enough to the extent of effective administration of investment incentives. They lack both human and other sources capacity. The main challenges of effective audit and enforcement are weak coordination and information exchange both internally and externally. Another problem is lack of proper attention towards effectively applying the available mechanisms. The requirement providing financial statements of related business is not applicable. The punishment in case misuse is insignificant. Thus, improved enforcement capacity is crucial way of controlling and monitoring incentives. Enforcement may start from permission process to the implementation stage. Next to enforcement, strong audit system is also selected as a mechanism to monitor and control. Properly implemented audit system (both tax audit and post clearance) helps to at least reduce incentive abuses and ensure its use to the intended purpose.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter contains two major sub-titles: conclusion and recommendations. In the conclusion part, major findings of the study on each research question which are drawn from the discussion of findings and results (of the data analysis) have concluded on the basis of objectives of the study. In this part, it has been tried to answer each research question briefly. Consequently, the recommendation part provides some appropriate solutions for the finding concluded in conclusion part.

5.2 Conclusions

The study was set out to assess the challenges of tax incentives on government revenue in the case of Ethiopian Revenue and Customs Authority. The study has also sought to identify the factors affecting the administrative capacity of tax incentives, the techniques in which beneficiaries abuse their investment incentive privileges, examine the effects of the legal framework and administrative procedures in the administration of investment incentives and assess the revenue forgone by government as a result of the tax incentives granted for investors. It was also set out to examine appropriate mechanisms to improve proper implementation of the incentives.

The general theoretical literature and research on this subject and especially in the context of ERCA is inconclusive on several vital questions within the investment incentives. The study sought to answer five of these questions: 1) What are the factors affecting the administrative capacity of tax incentives?, 2) How much is the revenue forgone by government as a result of the tax incentives granted for investors?, 3) What are the effects of the legal and administrative frameworks in the administration of investment incentives?, 4) What are the techniques in which beneficiaries abuse their investment incentive privileges? and 5) what are the basic appropriate mechanisms to improve proper implementation of the incentives?

Therefore, based on these questions the following conclusions could be drawn regarding each research question.

Complexity of laws and regulations, interference from other government organs, complexity of administrative procedure, incapability of staff to administer, lack of experts and intervention from top and middle level management of ERCA are the major challenges in the administration of investment incentives in their order of seriousness. Moreover, though some challenges are applicable to Kaliti Customs Branch Office too, there are some problems specific to the branch office. Such problems include; lack of commitment to the administration, internal and external intervention and insufficient work manual.

Cost of revenue is one of the costs among others incurred due to tax incentives. During the study periods a total of around 244 billion birr tax incentives were granted to eligible beneficiaries. In the fiscal year 2006/2007 a total amount of Birr 3.6 billion duties and taxes were exempted as incentive and this amount increased from year to year and finally reached to Birr 66 billion in the 2015/2016 fiscal year. In general, the tax incentive amount granted by the government during the study period shown an annual average growth rate of 40%. The revenue forgone as a tax incentive is a cost to the government it obliges to find other means of financing. As the data indicates, government grants huge amount of revenue as a tax incentive to the eligible beneficiaries when compared to the amount of indirect revenue collected by ERCA.

The data collected from ERCA & MOFEC shows that, revenue generated from own sources take the major share of government financing. From the total government revenue for the period 2006/2007 up to 2015/2016, the share of tax revenue is 83% for the given period, others grants and borrowing have their own share. The public goods and services provided by the government are covered by these sources, then while the government forgone revenue for some purposes it requires to shift to other financing sources to fulfill its obligation. Government obliged to find grants or borrowings unless it designs other means of tax revenue like diversifying tax base or increasing tax rate or find other non-tax revenue source. The amount of tax incentives granted during the study period is a significant amount and could increase the government revenue and minimize the financial resource gap. If the government had not been granted the tax incentives and it had collected, the possible changes occur on the country's budget deficit.

The tax to GDP ratio measures the countries capacity of utilizing own sources. According to the data obtained from Macro Economic policy and Management section of MoFEC; the tax to GDP ratio in Ethiopia increases up to year 2010/2011, between & after that it decreases for three years

and again it starts to rise in the year. But when we examine the tax to GDP ratio of some Sub-Saharan African countries based on the data from World Bank, (2016); Ethiopia's tax to GDP ratio is much less than the SSA countries and this implies that the tax revenue in the country is minimum. If the forgone amount had been collected the share of tax to GDP can rise to some extent. For example the tax to GDP can rise from 11.5 to 15.3% in 2011/2012, from 12.4 to 16.3% in 2012/13, from 12.7 to 16.6% in 2013/14, from 13.4 to 18.7% in year 2014/2015 and from 12.9 to 17.7% in 2015/2016.

The basic laws governing incentives in Ethiopia are proclamation No. 769/2012 and Regulation No.270/2012 which are issued by the legislative and Council Ministers respectively. But, laws and regulations are not the only sources of investment incentives. The finding shows that the government has no sufficient laws especially procedures that enable the administrative bodies to administrator the incentive system effectively. It is also found that, existing laws do not clearly state the powers and responsibilities of different bodies involving in the implementation of incentives. It lacks clarity and understandability both to regulatory bodies and beneficiaries to comply with. It does not have clear provisions that state penalties and administrative measures in case of abuses. Laws lack coordination with administrative procedures. There is also frequent change in laws. As a result, Legal Complexity is could be considered as causes administrative complexity.

The legal and administrative framework in Ethiopia are fragmented and not properly coordinated for monitoring and evaluation purposes. This has invariably resulted in an unevaluated investment incentive system which has the potential of facilitating illegitimate transactions, expropriation country resources and financial outflows abroad. The government lacks sufficient procedural laws that enable the concerning administrative bodies, particularly ERCA to administrate tax incentives effectively. Existing laws lack clarity for implementation and to comply with. They do not adopt clear provisions that state the powers and responsibilities of different bodies involving in the incentive implementation. They also lack coordination with administrative procedure on the ground. Moreover, there is frequent change in laws (both formally and be different subsidiary laws) which affects the certainty in decision making and encourages subjective decision making. As a result, legal complexity could be considered as administrative complexity.

Though ERCA and EIA are the major institutions assigned with administration of investment incentives, there are many bodies which involve in the implementation of incentives from both federal and regional government. The powers and responsibilities of bodies involving in the incentive implementation are not clearly stated. ERCA is clearly lacking inter-agency coordination of the institutions involved in managing tax incentives (from approval to administration). There is no inter-agency coordination or information exchange after incentives have been approved. This absence of proper inter-agency co-ordination provides fertile ground for serious levels of tax avoidance and other abuses.

ERCA lack administrative capacity of incentives programs. The authority in general faces the following challenges in the administration of incentives in their sequence of serious: complexity of laws and regulations; interferences from other government institutions; complexity of the administrative procedure; complex nature of incentives; weak staff capacity to administer the incentives program; lack of attention to its administration at institutional level and interference from top and middle level management of the authority faces challenges such as lack of adequate information, lack of interest compared to other revenue generating areas, interventions from bodies and insufficient working manuals.

There are two general considerations that should be taken in to account in designing investment incentives; administrative considerations and designing considerations. The administrative capacity of ERCA in general did not taken in to account in designing investment incentives. Similarly, that of Addis Ababa Kality Customs Branch Office in assigning incentives related tasks to the branch office only. Inceptives regimes are prone to various abuses. As such, an assessment of the impact of tax incentives on the administrative capacities of tax administrations and the compliance behavior of taxpayers cannot be overemphasized. Inceptives that do not taken into account the limitations of the tax administrations capacities could be considered as cost-ineffective.

As the report of A.A Kality Customs Branch Office and ERCA Head Office indicates; many incentives are exploited by investors. From different investment sectors; agricultural, Industry hotel & tourism, construction and mineral investment sectors are the major which is abused by

the investors. Related to this; customs duty and tax holiday are the major type of tax incentives which is abused by different investors.

Exemption from paying customs duty is more difficult to administer than other types of incentives. Different factors have contributed for the abuses of incentives both internally and externally. The internal factors related to laws and institutional arrangement. The external factors related to the intervention from different bodies and lack of coordination and information exchange.

The complexities of laws increase the compliance burden for investors and make it harder for the tax administration to administer the tax system. To minimize this effect; incentives require adequate monitoring and control mechanism. There are various mechanisms to improve administration of investment incentives including; keeping the system simple, strong both tax and post clearance audits, law enforcement backed by appropriate penalty and requiring the financial statements of related business. Due to the involvement of various organs in the system; the incentive system of the country is complex. Though audit system and enforcement are the major mechanisms applied in the country, they are not strong enough. There is no mechanism of requiring financial statements to related business. Similarly, the available penalty in the cases of abuses is insufficient. Therefore, the best policy option is attaching appropriate control and monitoring mechanisms to ensure its expected outcomes.

5.3 Recommendations

Based on the findings as per the research questions, the recommendations of this study focus for law makers and policy makers in general. There are also particular recommendations for the Ethiopian Revenues and Customs Authority and EIA to improve tax incentives administration. Therefore based on the considerations of the finding, the following recommendations are made:

5.3.1 The Government

- ✓ Beside a desire to increase investment; tax incentives have different costs. The choice among tax incentives requires the analysis of the potential benefit and cost. But, though the Ethiopian government place high emphasis on tax incentives as a tool of investment policy, their possible impact on investment and revenue were not clearly analyzed & known. There were no mechanisms to measure the effectiveness of tax incentives in Ethiopia. Therefore, besides designing tax incentive as investment policy, the government should have a mechanism to measure the true role, effectiveness and impact of tax incentives on the economy. In addition, the government should regularly prepare tax expenditure statements to measure and monitor the cost of tax incentives and better assess the effectiveness of tax incentives in meeting the desired goals.
- ✓ The responses from different agents in tax incentive policy implementation and users show that there was high level of corruption and other related frauds in tax incentive administrations. Corruption and other related frauds affect the economy of the country by creating an uncompetitive business climate. Therefore, the government should take corrective measures including reduction in discretionary power and effective measures on any agent theses initiate, facilitate, or participate in corruption and other related frauds by formulating and implementing updated laws & regulations and other technological controlling systems.
- ✓ Appropriate implementation of tax administration of tax incentives policy among other requires clear and fair legislations. Besides drafting the frame work, since investment and the related frauds were diversifying every day in terms of patterns and ways, these legal frame works should be amended continuously based on necessity to make them up to date. However, tax incentive policies, laws and administrative procedures is concerned bodies were not amended in response to different requirement. These call for incentive policies to be reviewed periodically to facilitate tax incentive administrations on one hand and to monitor

and control the ongoing complex frauds related to tax incentives and investment on the other hand. Furthermore, incentives should be granted and implemented with a little discretion and as much transparency as possible only through legal criteria

5.3.2 Ministry of Finance and Economic Cooperation (MoFEC)

- ✓ The power to prepare tax and customs laws and the preparation of the directives for the better implementation of tax and customs proclamation and regulations was vested to the Ministry of Finance and Economic Cooperation. Thus, the organization, based on studies and in collaboration with the concerned administrative agencies, should recommend appropriate measures on legislation to the legislative branch of the government and strive for its approval. Furthermore, it is better continuously review the administrative procedures and make necessary amendments
- ✓ It also better play a leading role in the establishment of mechanisms to measure the role, effectiveness and impact of tax incentive on the economy.

5.3.3 ERCA and EIA

- ✓ The tax expenditures are the opportunity costs of the society at large. So it should be properly recorded and reported to the general public; starting from the eligibility criteria till its final reporting. There should be a clear and transparent way of managing the tax incentive system. Unless there is clear and transparent system in the administration of tax incentive, there will be a huge deadweight loss to the society at large and it may create difficulty to measure the benefits gained on tangible and scientific manner as well as it will prone to abuse by different parties.
- ✓ To facilitate monitoring and evaluation of incentives as well as curb unintended abuse, investment incentives should be introduced for a fixed period and be renewed only after evaluation and enactment of the legislation.
- ✓ Law enforcement should be improved and there should be meaningful penalty in case of abuse that could deter others not to involve in similar crimes.
- ✓ They should build capacity to effectively monitor tax incentive claims (including access to an electronic registry of investment declarations) and periodically carry out audits of cases where tax incentives have been claimed to ensure that they are not misused.

- ✓ Information about each incentive scheme should be published and posted on relevant government websites, including comprehensive descriptions of each scheme.

Recommendations for Future Researches

This study focuses on the general challenges of tax incentives on the government revenue in the case of Ethiopian Revenue and Customs Revenue. In this research; only incentives related with tax and customs duties have been studied. Each point is analyzed in light with its revenue forgone, mechanisms to abuse tax incentives, legal frameworks and administrative difficulty. However, since the area is wide; it needs various detail researches. Therefore the following areas are recommended for the future research.

- ✓ Administrative Challenges of Non-Tax incentives
- ✓ Stakeholders role in the administration of investment incentives
- ✓ The role of investment incentives in Ethiopia

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ANNEX I (QUESTIONERS)
ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF PUBLIC ADMINISTRATION & DEVELOPMENT MG'T
QUESTIONNAIRE FOR EMPLOYEES of ERCA & EIA

Dear Respondent

The purpose of this questionnaire is to collect data that are required to analyze and assess “The Challenges of Tax Incentive on government revenue collection and administration: In the Case of ERCA.”

The data will be applied for the study leading to a master’s degree requirement in Public Management and Policy. The information you provide in this questionnaire will be kept confidential and utilized only for the purpose of this study. Your genuine response is highly valuable for the achievement of the objectives of this research.

Thank you in advance for your cooperation in filling this questionnaire.

Notes: There is no need to write your name

Best Regards

Dereje Tilahun

0911055140

Part I. Questionnaire about personal data

- 1.1 Sex Female Male
- 1.2 Age 20 - 30 31 – 40 41 - 50 51 and above
- 1.3 Education Background
- Certificate BA/BSC PhD
- Diploma MA/MSc Other (Specify) _____
- 1.4. Experience
- <5 6-10 11-20 21-30 > 31
- 1.5. Current job position
- Officer Senor Officer Team Leader Process owner
- Other _____

Part II. Questionnaire about the study

- 2.1 What do you think the major administrative challenges of investment incentives in ERCA & EIA in general? (Please circle one or more of alternatives below)
- A. Complexity of law and regulations
 - B. Complexity of administrative procedures
 - C. Lack of capacity of the staff to administer incentive program
 - D. Interferences of other government institutions
 - E. Interferences of top and middle level managers of the ERCA & EIA
 - F. Lack of attention to investment incentives at organizational level
 - G. Complexity nature of investment incentives
 - H. Lack of experts
 - I. Other challenges. Please specify, If any _____

2.2 Please rate the following statement regarding occurrences of abuse of investment incentives in Ethiopia by putting \surd mark on the space provided (NB: **VH=very high H=high M=medium L=low VL=very low NE=none**)

No.	Statement	VH	H	M	L	VL	NE
1	False claims in order to benefit from tax incentives						
2	Leave the incentive area upon the expiry of incentive period						
3	Engage in practices that will enable them to benefit from incentive schemes multiple times						
4	Close the old investment for which the incentive period is expired and restart the same operations under a different name						
5	Sell the business at the end of the incentive period to a new investor who then claims a new incentive.						
6	Winding up their operations at the end of the incentive period and move on to another country						
7	Over valuation/Under valuation of capital asset						
8	Transfer of domestic investment capital outside the country and return it as a foreign investment						
9	Transfer of duty free goods to a non-beneficiary 3 rd party						
10	Artificial manipulation of the price in transaction between two related entities (transfer pricing)						
11	Corruption in the process of granting incentive						

2.3 What do you think the probable solution is to reduce the abuses you identified above?
(Circle one or more about alternative below)

- A. Strong regular audit system
- B. Improving enforcement and monitoring capacity
- C. Requiring financial statements of related business
- D. Keeping the incentive system simple
- E. Other solutions. Please specify. _____

2.4 Do you think that ERCA has adequate monitoring and enforcement mechanisms to administer investment incentives?

- A. Yes
- B. No
- C. I don't know

2.5 If your answer for the above question is “yes”, what mechanisms are available?

- A. Audit system
- B. Regular monitoring their performance
- C. Law enforcement
- D. Other _____

2.6 Which is more responsible to protect and control the misuse of duty free privilege? (Please circle one or more of alternatives below)

- A. ERCA
- B. EIA
- C. Regional investment agencies
- D. MoFEC
- E. Others. Please specify _____

2.7 Please rate inter-agency coordination between ERCA and other government institutions
(NB: VP=Very Poor P=Poor F=fair G=Good VG=Very Good)

No.	Coordination	VP	P	F	G	VG
1.	ERCA and Ethiopian investment Commission (EIC)					
2.	ERCA and Regional Investment Agencies					
3.	ERC and Other incentive related government agencies					

2.8 What are major administrative challenges of ERCA in the administration of investment incentives? (Please circle one/more of the alternatives below)

- A. Lack of trained human power
- B. Lack of office and other facilities
- C. Lack of clear work manual
- D. Lack of interest of enforce and implement incentive laws in the same manner as revenue generating area
- E. Lack of awareness of staff towards incentives
- F. Intervention by political leaders or other government bodies
- G. Complexity of laws regulations
- H. Others _____

2.9 Which of the following is major cause for the misuse of tax incentives?

- A. Formulation of Weak Tax law and its implementation
- B. Absence of controlling and follow ups
- C. Corruption
- D. All
- E. None

2.10 Do you believe that most tax incentive users know their accountabilities with regard to the use of incentives such as duty free privileges?

- A. yes
- B. No
- C. I don't know

2.11 How do you evaluate existing laws and regulations that govern investment incentives?

(NB: SDA=Strongly Disagree DA=Disagree NN=neither Agree nor Disagree A=Agree SA= Strongly Agree)

No.	Statement	SDA	DA	NN	A	SA
1.	The existing investment rules and regulations are sufficient for proper administration of investment incentive regimes.					
2.	Investment incentives laws and regulations clearly state the powers and responsibilities of concerned government bodies regarding administration of those incentives.					
3.	The existing investment incentive laws and regulations are clear and easily understandable for the implementation.					
4.	The existing investment incentive laws and regulations clearly state penalties and other administrative measures in case of abuse of investment incentives.					
5.	The existing investment incentive laws and regulations are clear and easily understandable for the beneficiaries of incentives to comply with.					
6.	The existing laws, regulations and directives are adequate for the proper administration of investment incentives.					
7.	The existing investment incentive laws adopted clear and effective legal provisions on detections of abuses of incentives.					
8.	The legal and administrative frameworks regarding incentives are properly coordinated for monitoring and evaluation purposes.					

2.12 How do you evaluate the level of tax incentive schemes and the amount of revenue forgone by the government, when compared with its broader development objectives and its investment attraction strategy?

2.13 How do you evaluate the sectorial distribution of tax incentive schemes in Ethiopia?

2.14 How do you see the distribution of tax incentive schemes on beneficiary bases?

2.15 Do you think that the favored sectors are generating the required economic benefits as needed?

- A. Yes B. No C. I don't know

2.16 In your opinion, what are the benefits gained from granted tax incentives in Ethiopia?

2.17 Do you believe that the concerned body measure the benefits granted against the revenue forgone?

- A. Yes B. No C. I don't know

2.18 Do you think that the tax incentives granted by the government are properly understood and used by beneficiaries?

- A. Yes B. No C. I don't know

2.19 Do you believe that investment incentive legislations have taken in to account the administrative capacity of ERCA?

- A. Yes B. No C. I don't know

2.20 Write any of your comment with regard to tax incentive problems and there solutions_____

Thank you very much!!

Annex-II
Interview Questions for ERCA and EIA Officials

1. Sex _____
2. Age _____
3. Level of education _____
4. Work Experience _____
5. How do you evaluate the level of tax incentive schemes and the amount of revenue forgone by the government, when compared with its broader development objectives and its investment attraction strategy, Is it evaluated in terms of cost-benefit? What are the benefits gained?
6. What are the major challenges of ERCA or EIA in general and Addis Ababa Kality Customs Branch Office in particular in the administration of investment incentives
7. What are the limitations of laws in regulating investment incentives?
8. How do you evaluate inter agency coordination between ERCA or EIA and other government institutions involved in investment incentives and what solution do you propose to tackle these challenges?
9. What general comment or opinion do you have regarding investment incentives?

Thank you very much!!

Annex-III

Profit/Loss Declaration of MNEs

Company	Declared loss or profit in year (Birr)				
	2008	2009	2010	2011	2012
1	Loss	Loss	Loss	-	-
2	471,771.1	1,907,798.46	543,435.51	863,377.89	621,288.12
3	66,365,064.90	14,986,134.90	Loss	Loss	Loss
4	1,364,852.15	1,828,525.27	1,860,784.00	1,621,009.03	3,254,417.57
5	No operation	Loss	Loss	Loss	Loss
6	Loss	912,127.61	4,316.79	Loss	Loss
7	Loss	Loss	Loss	Loss	-
8	110,624,082.49	153,656,269	151,546,708.51	-	-
9	Loss	Loss	Loss	Loss	Loss
10	Loss	Loss	Loss	Loss	-
11	Loss	35,040,375.19	92,168,288.25	43,662,413.13	-
12	543,038.86	Loss	Loss	Loss	Loss
13	17,843,858.90	73,690,032.82	74,709,517.99	28,327,413.17	20,449,564.37
14	Loss	110,652,780.27	Loss	Loss	Loss
15	Loss	Loss	-	-	-
16	-	7,587,521.48	6,861,423.30	9,992,553.00	6,638,385.00
17	Loss	127,404.64	1,225,046.10	1,661,289.60	2,115,887.40
18	1,891,226.28	Loss	Loss	Loss	4,163,640.90
19	756,204.86	1,261,788.98	1,792,323.18	2,112,497.18	2,224,226.30
20	787,886.64	646,011.43	201,128.84	23,846.51	Loss

21	Loss	2,029,100.35	1,384,866.11	Loss	Loss
22	1,671,661.26	3,156,389.54	Loss	13,579,247.52	10,935,971.18
23	No Operation	No Operation	Loss	Loss	Loss
24	353,315.00	1,751,755.50	Loss	Loss	Loss
25	1,310,283.60	1,429,438.50	Loss	511,144.50	Not declared
26	Loss	707,991.15	Loss	1,678,621.20	4,036,452.30
27	3,990,839.45	3,170,851.54	3,618,745.00	5,434,661.53	4,472,644.37
28	Loss	Loss	Loss	Loss	342.21
29	10,046.70	Loss	Loss	Loss	Loss
30	Loss	1,069,205.05	2,793,759.64	Loss	Loss
31	Loss	7,402,235.49	Loss	Loss	6,298,445.00
32	Loss	Loss	Loss	Loss	Loss
33	466,148.00	881,662.80	216,233.70	1,001,306.40	2,296,119.00
34	Loss	Loss	Loss	Loss	Loss
35	No operation	Loss	Loss	Loss	Loss
36	1,923,257.14	1,840,253.54	2,119,645.21	3,769,922.24	7,403,566.07
37	8,277,585.60	6,275,208.30	8,554,351.50	13,453,518.60	13,371,700.50
38	1,276,441.22	2,116,069.22	2,026,479.69	1,196,600.84	707,899.17
39	7,843,790.00	5,519,914.80	8,969,589.00	10,084,613.40	21,303,465.30
40	No Operation	Loss	Loss	Loss	Loss
41	2,573,543.24	2,870,899.82	1,083,744.76	562,609.30	Loss
42	1,766,667.23	318,559.30	417,356.09	372,890.46	Loss
43	Loss	Loss	loss	Loss	Loss
44	Loss	Loss	loss	Loss	Loss

45		1,257,973.80	2,438,139.30	3,907,850.10	3,443,973.80	2,974,347.00
46		No Operation	Loss	19,713,347.00	15,145,531.83	2,604,951.60
47		Loss	Loss	loss	Loss	Loss
48		804,427.18	2,381,497.80	5,199,674.70	5,680,577.40	7,030,074.90
49		Loss	1,358,128.20	loss	1,327,066.20	2,220,437.10
50		Loss	Loss	loss	3,739,845.26	2,220,437.10
51		430,235.40	498,173.40	351,796.50	686,765.10	Loss
52		Loss	33,818.55	173,886.37	1,626,174.21	Loss
53		2,931,257.24	1,085,168.50	2,192,621.35	4,300,235.11	7,804,033.75
54		3,398,919.39	3,928,183.08	3,484,744.99	41,704,038.97	3,375,296.13
55		531,681.60	1,133,276.10	2,197,179.90	2,224,368.14	3,831,606.99
56		3,359,619.00	7,584,747.60	6,876,849.90	10,856,770.39	14,292,078.32
57		11,122,907.93	19,603,573.90	39,307,193.86	12,145,041.52	51,532,788.00
58		Loss	Loss	loss	Loss	Loss
59		Loss	Loss	loss	Loss	Loss
60		Loss	1,160,976.60	1,290,050.70	2,025,047.10	3,764,408.40
61		607,669.80	1,160,976.60	1,290,050.70	2,025,047.10	3,764,408.40
MNEs declared loss	F	24	22	28	25	26
	P	38.71	35.48	45.16	40.32	41.94

Source: ERCA Audit report and SIGTAS collected and processed by Tekalign Tamiru