

# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**



**ADDIS ABABA UNIVERSITY  
COLLEGE OF BUSINESS AND ECONOMICS  
DEPARTMENT OF ACCOUNTING AND FINANCE**

## **VALUE ADDED TAX REFUND PRACTICES AND REVENUE PERFORMANCE IN ETHIOPIA**

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# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

## **Statement of Declaration**

I have carried out independently a thesis on -VAT Refund Practices and Revenue Performance in Ethiopia: The case of the Federal branch office of ERCA in partial fulfillment of the requirements of the MSc Degree in Accounting and Finance with the constructive guidance and support of the research advisor.

This thesis is my own work that has not been presented for any degree or diploma program in this and any other institution and that all source of materials used for the thesis have been duly acknowledged.

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# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

## **CERTIFICATION**

This is to certify that Seada Kedir has carried out a thesis on the topic entitled “VAT Refund Practice and Revenue Performance in Ethiopia: The case of Federal Government office of ERCA” under my supervision. In my opinion, this thesis is suitable for submission in partial fulfillment of the requirement for the award of the MSc Degree in Accounting and Finance.

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**November, 2018**

**Addis Ababa**

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## **Abstract**

*This study examines VAT refund practice and revenue performance in Ethiopia. Specifically the study investigates key problems on VAT refund operations, in respect of the appropriateness of document verification and time to refund pay, type of refund claims and its legal framework, cause for VAT refund, trends of VAT refund and revenue performance in Ethiopia focusing on federal government. The study adopts mixed method approach specifically, the study uses in-depth interviews with tax officials and taxpayers and documentary analysis as principal way of acquiring data. With these research methods, the results of the study reveal that VAT refund practice remains infant. Since, it did not get appropriate attention of tax administration and the activities performed targeting specific taxpayers (medium and large taxpayers office) with the absence of developed risk-based refund claim verification and absence of effective IT support in refund processing (the refund process is mainly performed manual based) which results slow VAT refund process and due to enormous document verification the tax officers are tedious even some illegal taxpayers applied duplicated refund claim resulting loss of revenue.*

*Finally, the performance of VAT reduced due to VAT refund fraud, resulting in average 14% c-efficiency ratio which is lower when compared to competitor's country in Africa and in the world. At the end, the study forwards the possible measures to be taken and the necessary emphases should be given mainly on document verification that should be risk based and develop effective use of IT system to perform VAT refund process by the Ethiopian Revenue and Customs Authority to mitigate problems of slow VAT refund practice and low VAT revenue performance.*

*Key words: VAT, administration, refund, performance and Ethiopia.*

# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

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# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## Table of Contents

<b>ABSTRACT</b> .....	<b>I</b>
<b>ACKNOWLEDGMENT</b> .....	<b>II</b>
Table of Contents.....	iii
<b>CHAPTER 1-INTRODUCTION</b> .....	<b>1</b>
1.2. STATEMENTS OF RESEARCH PROBLEMS .....	5
1.3. BROAD OBJECTIVE AND SPECIFIC RESEARCH QUESTIONS .....	7
1.4. RESEARCH QUESTIONS.....	7
1.5. THE RESEARCH METHODOLOGY .....	<b>ERROR! BOOKMARK NOT DEFINED.</b>
1.6. SIGNIFICANCE OF THE RESEARCH.....	7
1.7. SCOPE OF THE STUDY .....	7
1.8. LIMITATIONS OF THE STUDY.....	8
1.9. STRUCTURE OF THE STUDY.....	8
<b>CHAPTER 2- LITERATURE REVIEW</b> .....	<b>9</b>
2.1. THEORETICAL LITERATURE.....	9
2.1.1. VALUE ADDED TAX (VAT) FEATURES AND ADMINISTRATION.....	10
2.1.2. VAT REFUND.....	15
VAT REFUND FRAUD.....	19
2.1.3. THE VAT REVENUE PERFORMANCE AND MEASUREMENT SCHEMES .....	22
2.1.3.1. Collection Efficiency (C-efficiency) .....	24
2.1.3.2. VAT Productivity .....	25
2.2. EMPIRICAL LITERATURE.....	26
2.3. CONCLUSION AND KNOWLEDGE GAP.....	30
<b>CHAPTER 3-RESEARCH METHODOLOGY</b> .....	<b>32</b>
3.1. RESEARCH OBJECTIVE AND RESEARCH QUESTIONS .....	32
3.2. RESEARCH APPROACHES.....	32
3.3. RESEARCH APPROACH ADOPTED .....	33
3.3.1. Qualitative aspects.....	34
In-depth interview.....	34
Documentary analysis.....	34
3.3.2. QUANTITATIVE ASPECT .....	35
3.4. Conclusion.....	36
<b>CHAPTER 4- RESULTS AND DISCUSSION</b> .....	<b>37</b>
4.1 RESEARCH OBJECTIVE AND QUESTIONS:-.....	37
4.2. RESULTS.....	37
4.2.1. RESULTS OF IN-DEPTH INTERVIEW AND DOCUMENTARY REVIEWS.....	37

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

VAT refund procedures (in processing and refunding excess VAT credits) in Ethiopia.....	38
VAT Refund Related Challenges that Tax Administration and Taxpayers are Facing.....	43
Causes for VAT Refund Claims in Ethiopia .....	47
4.2.2. Value Added Tax (VAT) Revenue Performance .....	49
4.3. DISCUSSION.....	55
<b>CHAPTER 5- CONCLUSIONS AND RECOMMENDATIONS.....</b>	<b>66</b>
5.1. CONCLUSION .....	66
5.2. RECOMMENDATION .....	69
REFERENCES .....	71
Appendix 1– Tax administrators in-depth interview instrument.....	81
Appendix 2 –Refund claimed Taxpayer’s in-depth interview instrument .....	83
Appendix 3 Tables.....	83

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## List of tables

Table 4.1	the trend of VAT refund in the three Federal branch office of ERCA .....	100
Table 4.2	summary of VAT refund pay as % of gross VAT claims (Federal) .....	51
Table-4.3	the trend of VAT collection and refund request in ERCA .....	101
Table 4.4	total tax collection in ERCA (Federal VAT revenue) .....	102
Table 4.5	tax to GDP, VAT to GDP and VAT to total tax revenue in ERCA.....	103
Table 4.6	Summery of trends in VAT collection as a % total tax, GDP and indirect tax... ..	64
Table 4.7	trends in VAT collection, VAT to GDP and C-Efficiency in the 3 branches.....	65
Table 4.9	summary of C-Efficiency of VAT from its introduction to date .....	66
Table-4.8	Consumption Efficiency (CE) in ERCA .....	103

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## List of figure

Graph 4.1	VAT Collection and Refund request in ERCA.....	61
Graph 4.2	Trends of VAT Collections in ERCA.....	62
Graph-4.3	Distribution of Total Tax Revenue in different period .....	64

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## List of abbreviations

VAT	Value Added Tax
GDP	Gross Domestic product
MOFEC	Ministry of Finance and Economic Co-operation
AACCSA	Addis Ababa Chamber of Commerce and Sectorial Associations
EC	European Commission
ECA	Ethiopian Customs Authority
ECC	Ethiopian Chamber of Commerce
EFIRA	Ethiopian Federal Inland Revenue Authority
ERCA	Ethiopian Revenue and Customs Authority
EU	European Union
IRS	Internal Revenue Service
IT	Information Technology
MoR	Ministry of Finance
NBR	National Board of Revenue
OECD	Organization for Economic Co-operation and Development
GTP	Growth and Transformation Program
SMEs	Small and Medium Enterprises
UNDP	United Nations Development Program
WBG	World Bank group
SIGTAS	Standard Integrated Government Tax Administration System

## CHAPTER 1-INTRODUCTION

Tax administration is complex and dynamic responsibility. On a regular basis, leaders are faced with new issues, conflicting priorities, taxpayer compliance and emerging commitments (Thomson, 2008). As Berhan and Jenkins (2005) noted, governments of developing countries are eager to create modern tax systems although saddled with weak tax administrations and sometimes have experimented with tax administration mechanisms that inflict higher compliance costs on the private sector.

Henceforth, the task of creating a well-educated and highly compliant taxpaying citizen supported by an efficient and responsive set of tax administration requires considerable resources and time (Highfield and Baer 2000). Despite the fact that people need to pay taxes based on grounds of vertical and horizontal equities, it is not always the case that tax systems are graspable and transparent for taxpayers especially for less literate business operators. Since the business owners do not have simplified access and clarification for information of the tax laws, they lack awareness on tax rules and regulations.

Value Added Tax (VAT) is an indirect tax in which it is the most popular tax in the world, inspired by every Government for revenue potential. VAT is charged by a government on consumer's expenditure, which is directly collected from businesses on their business transactions and from importers on their imports. It is a tax on the value that a business firm adds to the things it buys from other firms in producing its own product (Thuronyi, 1996). VAT in principle the only tax on consumption by final consumers. Businesses should be entitled to deduct the tax on their purchases and offset that tax against the tax they normally collect on their own sales (Charlet and Buydens, 2009).

VAT was originally introduced in France (1954); and then over 165 countries have introduced some form of VAT –the only OECD country not to have done so is the United States (WBG, 2016). VAT has become the most common type of consumption tax for different reasons. Unlike income taxes, VATs do not distort consumption-savings and/or investment decisions. Because sellers can claim a credit for VAT paid on their inputs, there is no cascading of taxes as can occur with other consumption taxes. It is also neutral between the domestic production and imported goods when compared to an import tariff. It has been widely recognized that a well-

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

designed VAT can raise significant amount of revenue on a stable and sustainable basis and the decision to introduce a VAT has often been made for these reasons (Bird, 2008).

As IMF (2018) report, the weakness in VAT is refund systems since VAT is a tax on consumption that requires both timely and accurate refund for business firm who have excess credit. In this case the main actors of VAT taxation and refund procedures are the taxpayers and governmental tax authorities. Taxpayers in all countries almost are the same: physical persons and legal entities, institutions, local government bodies.

As expected, the diversity of situations faced by the taxpayers and tax authorities around the world, the specific details of the rights and obligations vary by country. However, taxpayers should pay the exact amount of tax that they are required for particular transaction and no less or more. This is the most vital underlying public policy of the whole tax system. This policy typically is illustrated in the refund procedures. The significance of the refund policy is directly linked to the core interests of both tax authorities and taxpayers (L-Claros, 2017).

According to Antic (2014) VAT refund is one of the key features for economy growth. It is generally accepted fact that the economic growth of the state is connected with the development and extension of the small and medium enterprises. Thus, creating the certainty and flexibility in tax particularly in VAT refund procedures and measurements the public will be beneficially impacted. So it is not easy to determine the performance of VAT in one country and it requires some measures to be efficient. VAT efficiency is defined as actual VAT collection as a share of its potential bases i.e. its consumption (Keen, 2013).

The remaining discussion in this chapter is structured in eight sections. The next section deals with the background of the study which is section two. The statement of the problem that motivates the researcher to conduct this study is the third section. Fourthly, the general objectives of the study stated followed by research questions in section five. Subsequently, the sixth section deals with the significance of the study. The seventh and eighth sections deal with the scope and limitations and structure of the study.

# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

## **1.1. Background of VAT in Ethiopia**

The government of Ethiopia like other governments seeks to raise revenue mainly through taxation in order to pay its expenditures especially on infrastructure development. According to the proclamation No. 587/2008 the responsibility to collect such revenue for the federal government rests up on Ethiopian revenue and customs authority (ERCA).

The design of the VAT legislation is intended to achieve the expected revenue projections, support capital investment and development, simplify its administration for the tax authority and the business community and minimize the tax burden for the lower income population (Abate T.M., 2014 2<sup>nd</sup> ed.p.615).

In Ethiopia VAT was introduced in 2003 after enactment of Value Added Tax proclamation No.285/2002 and its regulation No.79/2002. There are objectives for its introduction in Ethiopia which includes: (a) to bring greater transparency to the tax system, (b) to reduce the cascading (double taxation) of consumption taxes, (c) the consolidation of tax administration, (d) promotion of economic growth by promoting better use of domestic resources and (e) to bring greater stability to tax revenues e.g. shifting tax collection dependency from import to other sectors.

ERCA came into existence in 2008, by the merge of the Ministry of Revenue (MoR), Ethiopian Customs Authority (ECA) and Federal Inland Revenue Authority (FIRA) that formerly raise revenue for the federal government and prevent contraband with a vision to be a leading, fair, modern tax and customs administration in Africa. The reason for the merge was to minimize serious problems due to inefficient organizational structure and unnecessary complicated procedures which created insufficient service delivery, corruption, smuggling and tax evasion within the administrations.

Farther, ERCA were changed its name as Ministry of revenue and reform its organization structure by following the general change of the country which initiated to bring over all change in modernizing revenue administration and also to run with the new reform of the country in Nov. 2018.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

According to tax law VAT is levied on consumption of taxable goods and services supplied or imported into Ethiopia. It is collected by registered persons at designated points who then remit it to the tax authority. Registered persons only act as VAT agents in collecting and paying tax since the tax is borne by the final consumer of goods and services.

There are two tax rates applicable for VAT in Ethiopia: 15 percent, which is the standard VAT rate applicable to all taxable goods and services, zero rate applicable to a certain category of goods and services including exports among others and exemption on food staff, agricultural, education, health and the like, as amended VAT proclamation No.609/2017 with registration threshold of 1million ETB.

VAT refund occurs when a person or a business entity pays more VAT when they purchase tax able goods than they can collect whenever they sell the same goods. The difference is therefore, reclaimed from the tax authority. Generally, VAT refunds arise from the following scenarios: excess input tax resulting from zero rated supplies, overpayments or credits resulting from withholding VAT system and VAT paid in error.

Recently the government of Ethiopia plan to achieve the GTP II objective of over 17 percent tax-to-GDP ratio by 2020 that necessitates the improvement of tax administration practice particularly VAT, since it contribute more than other types of tax (AEO, 2016). In this study the researcher tries to see the VAT administration practice mainly focusing VAT refund procedure and revenue performance in Ethiopia. Since, it is important to note that all VAT refunds are paid out of VAT revenue collected in ERCA. This practice tends to; at times, adversely affect the performance of this tax type, beside its importance of timely and accurate refund for business entity. The performance of VAT and the associated refunds over the period were examined in the subsequent chapters.

## 1.2. Statements of Research Problems

From the researcher's point of view; properly designed and administered taxation system is very vital in generating revenue as well as increasing the tax base to the government of developed, developing and for transitional economies. As Bird (2008) noted that, it is unquestionable to ensure that the revenue collected from tax should be raised in efficient and effective manner even if it is difficult without fear or favor in countries that are politically fragile.

However, the tax base of developing countries adversely affected by administration problems including poorly considered tax policies and lack of certainty regarding future policy changes. Tax administration can also create problems for the tax payers as they impose heavy reporting and record keeping requirements, perform excessive inspections and audits, fail to deal with their corrupt employees and failure to provide transparency in the operations of tax refund and tax administration (Baurer, 2005). VAT playing great role as a major source of government revenue in Ethiopia, it has got difficulties in administration practices (Yesegat, 2008).

As Kibret and Mamuye (2016) noted, in the past decade Ethiopia has made encouraging progress in mobilizing more revenues from domestic sources, which is tax revenue particularly since the introduction of VAT. According to ERCA annual report of 2016 states that, the tax collection increased from Birr12.4 billion in 2005 to Birr 160.19 billion in 2016 indicating over thirteen fold increase in the decade. However, Kibret and Mamuye (2016) also noted, there is a challenge increasing the tax revenue proportionate to GDP; the tax to GDP ratio remained low at 13.4percent in 2015 which is below the Sub Saharan Average of about 18percent, over 20percent for emerging economies and above 30percent for developed economies.

As IMF (2016) noted, tax revenue collection of the Federal Government of Ethiopia is anticipated to be broadly in line with the annual budget plan, benefiting from good execution of direct and import taxes, while falling short in domestic VAT collection. To this end IMF suggest that in Ethiopia regarding tax administration, measures need to focus on improving VAT administration explicitly on tax audit and refund procedure to achieve the GTP II objective of over 17 percent tax-to-GDP ratio by 2020. This necessitates additional tax policy reforms including the review of existing VAT administration practice particularly modernizing VAT refund procedure using risk-based invoice verification, monitoring and improving IT system.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

As Antic (2014) illustrious, the policy of the whole tax system should energies to create an effective and fair tax system, it is vital to address the administration problems that affect and prevent loss of tax revenue. To the greatest possible extent, tax systems should be supported by clear and straightforward laws and procedures that facilitate revenue collection, develop taxpayer's awareness and minimize taxpayer's effort and compliance costs.

The economic policies of various countries witnessed the importance of VAT refund. Yet, in many developing and transitional countries, refund performance is reported as a weak feature of tax administration, irrespective of whether other aspects are working well (Krelove and Harrison, 2005).

There is no enough literature on the VAT refunds and revenue performance and the previous available study by Harrison and Krelove (2005) and keen (2013) was only focused on the group of country not on the specific country. So, it is not possible to get the detailed information for specific country on VAT refund practice and revenue performance.

So managing VAT refunds is one of the challenges of VAT administration in developing countries particularly in Ethiopia. VAT is a tax on consumption that requires both timely and accurate refund for business firm who have excess credit. That brings relaxed trade operation for business entity as well as tax authority to collect more tax over a period. as a result the researcher wants to asses VAT refund practice and revenue performance

To the knowledge, the above stated researcher there appear to be limited evidence on VAT refund practice, and revenue performance. Consequently; this study is more specific and concentrated on the essence of VAT refund practice, procedures, legal framework and causes for VAT refund, related challenges and revenue performance in the case of our country Ethiopia. Farther more, as per researcher previously mentioned there is also unclear VAT refund practice and revenue performance which resulting frequent complains of taxpayers on unpaid VAT refund in the tax administration. Thus; this thesis want to study the case and try to contribute its part.

The above problems together with the knowledge gap shown in corresponding literature reviews necessitate this paper on VAT refund practice and revenue performance in Ethiopia.

## 1.3. Broad Objective and specific research questions

The broad objective of this study is to assess VAT Administration practices focusing on VAT refund procedures and revenue performance in ERCA in the case of Federal Government in Ethiopian tax system. Thus, the study accomplished the following research question in line with the problems stated in the preceding section.

## 1.4. Research questions

*RQ1. How is VAT refund legal framework in light of experiences in other countries?*

*RQ2. What is VAT refund procedures employed in processing and refunding excess VAT credits in Ethiopia?*

*RQ3. What are VAT refunds related challenges the tax administration and taxpayers are facing?*

*RQ4. What are the causes for VAT refund claims in Ethiopia?*

*RQ5. How is VAT revenue performance in Ethiopia?*

## 1.5. Significance of the research

It is obvious that an economic development of a country can be stabilized by an effective and efficient administration and collection of taxes. So when the administration practice and revenue performance of VAT system is effective, the government's revenue that helps to fulfill the socioeconomic needs of the society will be enlarged. The primary use of this research is to the ERCA. The authority might be able to see its VAT performance and refund practice and build some corrective measures for the weaknesses based on recommendations to be forwarded. Further, the study has paramount use for taxpayers and different stakeholders who are interested in the field and for the researcher himself gain knowledge in the area. Finally, the study might have invaluable importance for future researchers who need to conduct a study in this and related fields.

## 1.6. Scope of the Study

The study was conducted in East, West and Large Taxpayer's Office of tax collectors and taxpayers in Addis Ababa Federal branch office of ERCA, which excluding regional government's tax office due to time and resource constraints. The study also focused on VAT administration practice mainly focusing on VAT refund and revenue performance in those branches. The study period cover from 2010 to2016 for VAT refund related issue and from the introduction to date for VAT revenue performance measure because VAT refund related issue

# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

was not properly practiced as VAT introduced. So, the study examined VAT refund practice and type of VAT refund performed; the trends of VAT refund procedure, related problems, cause for VAT refund and its revenue performance in ERCA.

## **1.7. Limitations of the Study**

First, no study or investigation exists without limitation. It is obvious that adequate, reliable and updated information is important to undertake any kind of study. In carrying out the study the accuracy of the study limited by: time and the willingness of respondents were constraint the in-depth discussion of the study. This was due to the fact that, the study may be very sensitive and balky, thus needed much time to gathering data and for discussion also and **lack of experience** of the researcher is another limitation to conducting this study.

## **1.8. Structure of the Study**

The final report of this study is presented in five chapters. The first chapter deals with introduction including background of the study, statement of the problems and objectives of the study, research questions and method adopted significance of the study and scope and limitation of the study. The related literature have been reviewed and presented in the second chapter. In the third chapter, the research design including the methodology adopted and techniques used in data collection and analysis is offered. Subsequently, the fourth chapter discusses the results and analysis of the findings of the study. Finally, the fifth chapter presents the conclusions and recommendations based on findings.

## CHAPTER 2- LITERATURE REVIEW

The purpose of this chapter is to review the literature in the area of VAT Refund and revenue performance. The chapter is organized in three sections. The first section reviews theoretical studies on VAT refund and revenue performance, while the second section presents the empirical evidence on the study area and related issues. The final section provides concluding remarks on the review of the literature and identifies the knowledge gap that has been addressed in the study.

### 2.1. Theoretical Literature

VAT is defined as a broad-based tax levied at multiple stages of production and distribution on commodity sales at up to and including at least the manufacturing stage, with critically systematic offsetting of input tax against output tax (Ebrill et al, 2001; Gendron and Bird, 2007). As the name suggests, it is meant to tax value addition that is created in each stage of manufacturing or distribution hence there should not be any cascading and the tax burden should ultimately fall on final consumption of goods and services. If the tax falls on intermediate transactions, it distorts allocation of factor inputs by firms and consequently reduces production efficiency hence competitiveness of a country (Myles and Hindrick, 2004).

VAT is also called the goods and services tax (GST), which levied on the value, added that results from each exchange (Herouy, 2004). It is an indirect tax collected from someone other than the person who actually bears the cost of the tax or the tax burden. Umeora (2013) noted VAT is also a tax on estimated market value added to a product or service at each stage of its manufacture or distribution and the additions are ultimately added to the final consumer, i.e. End users of products and services bear the tax burden or the incidence because they cannot recover the tax paid on consumption of goods and services.

The multipart tax system relatively successful, it should be approached strategically and realistically in order to maximize taxpayer participation, create an efficient refund and audit administration, and encourage private sector growth. Tax involves every aspects of income generating activities and consumption items, and requires not only administrative capacity of revenue authority but also the involvement of private sectors through proper accounting and reporting (Tadros 2009).

However, the task of creating a well-educated and highly compliant taxpaying citizen supported by an efficient and responsive set of tax administration requires considerable resources and time

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

(Highfield and Baer 2000). Despite the fact that people need to pay taxes based on grounds of vertical and horizontal equities, it is not always the case. Since the business owners do not have simplified access to and clarification on information of the tax laws, they lack awareness on tax rules and regulations (Kebrat, 2010).

There are various forms of VAT depending on the design features of the tax. Best practice and consensus strongly advocate for a broad-based consumption type VAT with a single rate, minimal exemptions and zero rating exports only (Ebrill et al., 2002). Some literature contend that if properly administered, such a VAT is buoyant (Tait, 1991) and revenue productive (Le, 2003).

ITD, (2013) the key features of VAT are that it is the broad based tax levied at multiple stages of goods and services, with crucially taxes on inputs credited against taxes on Output (refunded when the former exceeds the latter). That is, while sellers are required to charge the tax on all their sales, they can also claim a credit for taxes that they have been charged on their input. The advantage is that revenue is secured by being collected throughout the process of production (unlike a retail sales tax) but without distorting production decisions (as a turnover tax does).

Tax administration consists of several related but separable processes such as—registration, filing, payment, refund, audit, and enforcement. The researcher discussion focuses not on each of these, selectively VAT refund and revenue performance.

## 2.1.1. Value Added Tax (VAT) Features and Administration

VAT administration pertains to how tax authorities discharge the responsibilities entrusted to them. As cited by Awgchew.Y and ShimesK. (2012), “Jantscher (1990) these responsibilities include a range of related activities such as taxpayer identification and registration, invoicing, filing and payment requirements, control of filing and payments, refunds, audits and penalties”.

Moreover, many countries justify reduced rates as a way of not penalizing the poorest households for buying daily essentials since these households have high marginal propensity to consume – especially food and clothing. A single VAT rate with some compensatory measures targeted to the poorer households would be an ideal strategy in protecting the interest of the poor. Significant differences exist among experts regarding the basic features that should be taken into account for the successful implementation and effective administration of a VAT; however, in

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

the context of capacity building and strengthening, a lot of common grounds are apparent among many developing countries.

Most importantly, multiple rate structures and non-harmonized compliance and enforcement rules create unnecessary complexity, uncertainty, and inefficiencies. Wider definition of taxable person/enterprises (including government bodies), high registration threshold, single rates, minimal exemptions, and minimal zero-rated supplies are more preferred compared to the opposite cases, Lejeune (2011).

The major activities in VAT administration are identifying taxpayers, processing returns, controlling collections, making refunds, auditing taxpayers and levying penalties (Purhoit, 2000). On the part of administration, preparation of a single master file, based on unique tax identification number (TIN) is crucial and this ensures that each taxpayer's account contains all the relevant tax and payment data for that taxpayer alone. On account of requirements of VAT, the even functioning of VAT would depend upon tax payers keeping careful and complete records (Purhoit, 2000).

According to Minh Le (2003), VAT is, in principle, described as “self-enforcing.” The description stems from the nature of the invoice-based credit VAT: a taxable business can claim for the refund of the input VAT only if the claim is supported by purchase invoices—the mechanism provides strong incentives for firms to keep invoices of their transactions and is an efficient means for tax authorities to check and cross-check for enforcement enhancement.

To minimize the likely amount of high compliance costs, however, sellers are expected to maintain sufficient details to have information on the following aspects. These are particulars of invoices giving details of tax on sales and credit on purchases, detail of accounts giving information of all purchases and sales and interaction between invoices, purchases and sales account with the tax return form (Purhoit, 2000).

VAT execution is also part of VAT administration. This includes identifying tax payers and tax evaders as well as the registered and unregistered tax payers among the business community. It follows that the concerned tax authorities would take legal measures against people who do not comply with the VAT law. It is not only the authorities should be responsible in assessment of execution of VAT but the consumers themselves have a key role to play (Purhoit, 2000).

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

According to Minh Le (2003), VAT is relatively more advantageous than the alternatives, indirect tax. First, the VAT is generally more broad-based (it is extended to cover both goods and services). Second, it is less risky in terms of revenue leakage (the invoice-based credit mechanism in administering the VAT facilitates collection and enforcement; even if revenues are missed in one stage, they are still collected in other stages). The VAT has, therefore, greater revenue potential than its alternatives.

As Tanzi and Pellechio (1995) cited in Ott (1998) noted the main tasks of VAT administration involve: (1) information and instruction to taxpayers, (2) registration, organizing and processing tax returns (input of data, processing declarations and payments), (3) coercive collection (closely connected with registration, accounting and return processing), (4) control and supervision (discovering lacking and insufficient tax returns and controls of books and papers in tax administration offices or business activities and books of taxpayers, while routine check-ups had already been done in the registration, accounting and return processing department), (5) legal services and complaints (taking cases to court, defending tax administration in court, explaining procedures which are or are not in accordance with the law). The following compounds were key components of VAT administration;

According to Jantscher (1990) noted, in some developing countries taxpayers effect provisional payments monthly and file returns annually; while most developing countries require monthly filing and payment of VAT and do not require taxpayers to furnish a yearly return. He also noted, most developing countries require some form of invoicing for all transactions subject to VAT including sales to final consumers. Grandcolas (2005), Jantscher (1990) and Yesget (2008) noted that managing VAT refunds is one of the challenges of VAT administrations in developing countries which are discussed in detail above.

According to Bodin and paizan (2009) the introduction of VAT is the most important tax reform that has taken place in a majority of African countries in the past 20 years. While significant progress is still needed to improve VAT's efficiency, the overall results are positive. It facilitates a substantial improvement in overall tax administration, and indeed adoption of the VAT is often seen as an opportunity for overall tax administration modernization (ITD, 2013).

The ideal VAT is a transaction tax on all goods and services collected on sales at all stages of production and distribution. In advance Michael & Ben (2007) explore the causes and

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

consequences of the spread of value added tax (VAT). Emergence and rapid spread of VAT is among the most important tax development of the late 20<sup>th</sup> c. VAT introduced in 1954 by a French economist Maurice Laurie who was joint director of the French tax authority. Sokolovska and Sokolovskyi (2015). Its spread also has accelerated since, with strong support from the IMF, as it has now been implemented in 156 countries and in these countries it typically accounts for about one-quarter of all tax revenue. Despite its name, the VAT is not generally intended to be a tax on value added as such; rather it is usually intended as a tax on consumption. There for the theory is that the end user carries the burden of VAT, not the business, which is merely collecting the VAT on behalf of tax authority.

VAT as a Part of Indirect taxes which generate a substantial part of tax revenue in many developed and developing countries. In developing countries VAT would become a major sources of revenue it has an important contribution to total government tax revenue (Ajakaiye, 2000). It also a major source of tax revenue for every industrialized country in the world except the United States. Dubay (2010), Bendikienè and Saparnis, (2006) noted that, Goods and services are commonly charged with VAT aiming to collect as much funds into the state budget as possible and it is a key element of the tax system, which is a significant and important source of revenue in many states. According to the VAT scheme, the added value is created in each phase of the manufacturing process, so that each phase brings revenue to the state budget.

The concept of segmentation of taxpayers is a key component of the strategies to modernize the tax administration that have been developed since the second half of the 1990s. The rationale for organizing tax administration on the basis of specific categories of taxpayers enables this administration to develop a compliance strategy that includes the proper balance of service and enforcement programs that are needed to take into account the particular risks and needs of each group. After the creation of special units to administer the tax affairs of large businesses, establishment of dedicated offices and special programs for medium-sized businesses and for small and micro businesses is often seen as an essential step towards modernizing the tax administration (Bodin and paizan, 2009).

As Ebrill et al. (2001) and ITD (2005), demonstrate in detail, good VAT design makes good VAT administration easier and that bad design may make good administration almost impossible. Similarly, it is now well understood that VAT, like all modern taxes, requires both taxpayers and tax officials to behave properly if it is to work correctly.

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

VAT is characterized as most sensitive to the attitudes of the people paying their VAT. The attitude of tax payers highly determine the level to which tax is effectively collected. This - attitude of tax payers - in turn is highly determined by the level of strength and effectiveness of the administration of tax authorities. According to (Peacock and Forte, 1981: Cited in Angesom, (2013), a tax payer is more receptive to comply with his responsibilities to the extent that he receives a reasonable degree of service from revenue administration. Poorly drafted forms, long waiting lines and even charges for acquiring them, bureaucratic hassle in processing the case, rudeness from the officials, cumbersome appeal procedures, and the like, can repel even the most loyal taxpayers.

Harrison and Krelove (2005) provide a useful discussion of such methods. In particular, it is by no means clear that the public support needed to improve the administration of VAT really exists in many DTE. including relatively few large formal-sector firms who currently account for most of the revenues-while of course supportive of measures to extend the weight of the tax to their relatively 'untaxed' competitors in the informal sector—are understandably likely to react adversely to any measures tightening up the system as it applies to them.

According to Bohmer et al. (2007) the key precondition for efficient VAT administration is also its structure with minimizing distortions, strictly tax exemptions and elimination of the differences in tax treatment of particular parts of economy. This will mean extending the VAT to all but a few goods and services (notably export, which should be zero - rated, and banking and insurance services, where it may be difficult to determine the amount of value added to be taxed).

To this end an increase in revenue obtained from VAT collection and simultaneous increase of complexity of its administration. Olena and Dmytro (2015) stated on their study the tax exemptions, tax incentives, zero-tax rates, could be considered one of the main reasons of administration's complexity, which in turns favored to the growth of the shadow sector and the level of corruption.

There is no 'magic formula' to creating public support for better tax administration. However, there are many established and workable ways to do this critical and difficult job better that are currently in use all around the world (Bird 2004a). To this Ebrill et al. (2001, 141) recognize, the successful implementation of such a tax requires the prior satisfaction of a number of conditions.

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

Including: Simple, clear, stable tax laws, adequate service and support to taxpayers in complying with tax Obligations, Simple procedures for registration, filing, payment and refund, Effective collection enforcement, Reasonable audit coverage, Strict application of penalties and Provision for independent review.

## 2.1.2. VAT Refund

The VAT refund is an integral component of a modern VAT system. In principle, the statutory incidence of VAT is on the final consumer, not on businesses. According to tax policy guidelines set out by the Organization for Economic Co-operation and Development (OECD) 2016, a value-added tax system should be neutral and efficient.

The real world businesses sometimes incur VAT on expenses. These expenses may be related to the economic activity of those businesses in that country and, if so, those businesses should legitimately be entitled to recover the VAT charged to them on those expenses. Because VAT, by its very nature, is supposedly neutral for VAT payers, the burden of the tax should not fall on taxable businesses (IMF, 2013). VAT should only tax on consumption by final consumers. Businesses should be entitled to deduct the tax on their purchases and offset that tax against the tax they normally collect on their own sales (Charlet and Buydens, 2009).

On the other hand some businesses will incur more VAT on their purchases than they collect on their taxable sales in a given tax period and therefore should be entitled to claim the difference from the tax authorities (IMF, 2016). When businesses incur VAT which is not refunded at all – or reclaimed with delays and large compliance costs – then the principles of neutrality and efficiency are undermined. This alters the nature of VAT by effectively making it a tax on production (WBG, 2016). Any tax that cannot be recovered by the business could have a distortionary effect on market prices and competition and consequently constrain economic growth.

The International Monetary Fund's (IMF, 2013) Tax Administration Diagnostic Assessment Tool (TADAT) provides an integrated monitoring framework to measure the performance of an economy's tax administration system across different functions, including the adequacy of its VAT refund system. It does this by measuring the time taken to pay (or offset) refunds (Lopez-Claros, 2017).

Managing VAT refunds is one of the challenges of VAT administrations in developing countries. In managing refunds and combating refund frauds, different countries use schemes including

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

denial of refund claims (except to exporters), carrying forward of refund claims, demanding a third party certification of the claim, demanding guarantee, requiring taxpayers to have separate VAT bank accounts, zero rating of supplies to exporters and remission of input VAT on certain goods (mainly capital goods) (Grandcolas, 2005 and Jantscher, 1990).

VAT refunds in developing countries shows that all developing countries, give refunds to exporters and some require other VAT taxpayers to carry forward their excess credits indefinitely (Jantscher 1990). These schemes results not only to combat refund frauds, but are also intended to reduce the strain on business cash-flows.

ITD (2005) stats, refunding excess credits is straightforward in principle, formidable problems arise in practice, making the refund process arguably the Achilles heel of the VAT. First, the payment of refunds can create lucrative opportunities for fraud (e.g. exporters making false claims by overstating input taxes paid). Second, the power of tax officials to make refunds may invite corruption. Third, governments may be tempted to delaying refunds when their budgets are under pressure, thereby creating serious cash flow problems for businesses. This is particularly so in countries those pay refunds out of consolidated VAT collections rather than from specific expenditure appropriations.

On VAT refunds, economic theory and practice indicate that to be efficient, the VAT must be consumption-type, broad based and applied through to the retail stages (Le, 2003). The OECD (2014) asserts that VAT refunds emanate from the design feature of the VAT. The invoice credit form of VAT has a key feature that some businesses will pay more tax on their inputs than is due on their output, and so ought in principle to receive VAT refunds (Ebrill et al., 2001).

A consumption-based VAT requires investment costs and intermediate inputs be effectively excluded from the base. As such, a functioning refund system becomes essential for the VAT administration, and it is a crucial condition for the VAT to be an efficient, that is pure tax on consumption. Delay in VAT refunds would add a layer of “hidden costs” to registered firms and thereby discourage investment. The problem is especially serious for export manufacturers that usually have a huge backlog of refunds but must compete internationally (WBG, 2003 p. 43).

ITD (2013) noted, Approaches have emerged in an attempt to reduce the number of VAT refund claims and address business cash flow concerns. That includes, some EU countries (e.g. France and Ireland), as well as some countries in North Africa and Asia, have implemented schemes which apply a zero rate on supplies to exporters. While the perceived benefits of these

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

arrangements may be tempting, they add complexity to administration and open up new revenue risks, especially in developing countries and transition economies where administrative capacity needs significant strengthening.

Bird and Gendron (2005) noted When a VAT invoice is issued; in effect it constitutes a potential claim on the fiscal resources of the state. In the hands of a VAT registrant, such an invoice can be used in the first place as a deduction against any output tax due and in the final result it can become a direct claim for a refund. Government cash flow problems should be managed by better expenditure management, not by improperly withholding funds legally due to taxpayers. For example, in Jamaica, the government is supposed to pay interest at a rate of 2 ½ percent per month after 90 days on refunds that are not paid.

Properly managed and timely refund is essential to ensure the tax is an efficient and pure tax on consumption, any delay in VAT refund would add a layer of hidden costs to registered firms and thus discourage investment (Mnih Le, 2016). Since 2002, Germany has made the buyer legally liable for tax not paid by the seller, but this has had little effect because it is virtually impossible to prove that the buyer had any knowledge of the seller's intention not to pay the tax for which the buyer was claiming input tax credit. Germany has also tried to deal with the common use of new firms to commit VAT fraud by demanding some form of guarantee from them, but this too proved ineffective largely because firms can make claims and go bankrupt before the authorities get around to acting (Bird and Gendron, 2005).

On the other hand, there is legitimate requirement that refund claims be carefully processed, as the refunds normally account for a significant share of the total VAT collection (WBG, 2017). Bird & Gendron (2011) assert that it is desirable to restrict zero rating solely to exports to limit the potential range of legitimate claims. In addition, export sales against which input claims are made should be adequately supported by verified export declaration forms. Jurisdictions should aim to achieve zero zero-rating of domestic products.

The refund issue is tackled differently in different countries. Most cap the amount of refunds of the VAT on intermediate inputs and capital items at the level of the VAT on output in each tax period and allow for the remaining balance to carry forward over the following period(s). In Ghana, for example, the excess tax credit-or the excess of input tax over output tax-is carried forward for three months, and after that, the refund will finally be made. According to Le, (2003)

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

in Vietnam, for example, due to six-month delay in tax refunds, a typical export apparel-manufacturing project would lose 28 cents per each dollar of investment in the present value terms over its lifetime, while the loss to an export leather shoe-manufacturing project would be 5 cents.

The correct treatment for VAT refunds is simply to pay legitimate claims promptly and not to pay fraudulent claims at all. The problem, of course, is how to distinguish the good from the bad, is to be found not so much in special treatment of refund claims as in better administration of all aspects of the VAT system (Wakiaga, 2017).

In principle, when input VAT exceeds output VAT the amount should be paid as a refund to a registered business within the time period stipulated in the legislation. In practice, however, only 93 of the economies covered by Doing Business allow for a VAT cash refund (WBG, 2017)

ITD (2013) noted, failure to fully refund excess credits undermines the integrity of the VAT and the credibility of the tax administration. When tax authorities deny payment of legitimate refund claims, the VAT ceases to be a tax only on domestic consumption-it becomes, in part, a tax on production. Intermediate goods transactions are distorted; the competitiveness of the export sector is harmed; and the competitive edge is tilted against new firms with large start-up costs. In addition, compliance is seriously jeopardized if businesses lose faith in the VAT system and are motivated to operate outside the law and engage in tax fraud and evasion.

Like any tax, VAT is prone to fraud and its refund mechanism may be open to abuse by taxpayers. Delays in processing refunds, therefore, it may be the result of concerns over potential fraud (WBG, 2017).

VAT refund for exports is a critical issue. A destination-based VAT zero-rates exports; therefore, the sector is entitled to refunds of input VAT. However, VAT fraud is a common and acute problem: firms may produce false invoices or generate false exports for refunds. Some established firms may even engage in the business of selling fraudulent invoices. Tax administrations are required to prevent such fraud and, at the same time, to facilitate the VAT refunds for genuine exporters. Efficient programs for processing VAT refunds to exporters deserve special attention (WBG, 2003, p. 44,45)

According to Bodin and paizan (2009), the main difficulties in the area of VAT administration typically materialize several years after the introduction of the tax. In Africa, as in many other

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

developing countries, the VAT revenue efficiency commonly deteriorates in the medium to long term, if the administrative capacity is insufficient to effectively control claims for refund of excess input VAT, and to process the exporters' refund claims effectively and in good time. This situation leads to abusive practices and evasion, and pressure to exclude more activities from the VAT base.

### **VAT Refund Fraud**

Tax in a tax system is vulnerable for evasion and fraud, which has become the concern of many countries. For instance, Carousel Fraud and credit and/or refund abuse in European Union (EU) member countries (Keen and Smith 2007) and abuse of tax credit in Bulgaria (Pashev 2006) and the offence of non-issuance of value added tax (VAT) invoices in Ethiopia (Alemu and Deresse 2009) can be mentioned.

Tax fraud is an intentional reduction of the tax liability stemming from real transactions. As Baurer (2005) noted, it is a deliberate misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. It typically includes underreporting profits and turnover, overstating deductions, underreporting employee wages, failure to register or file tax declarations, hiding of taxable receipts coming from the production and distribution of real products and services, overvaluing of VAT spent on inputs and abuse of tax return through fictitious transactions and trades.

As Baer(2017)stated VAT refund fraud is a global problem, depriving tax administrations of significant revenue and affecting government ability to finance public services. Because the sums of money involved tend to be significant and the related risks of detection are low, fraudsters have targeted VAT refund schemes and, in some cases, have used the proceeds of their crime not only to steal revenue but also to finance other criminal activities.

According to Bird and Gendron (2005) VAT fraud may show up more explicitly in the budget than equivalent fraud with other forms of sales tax, since it (often) takes the form of explicit budgetary refunds rather than simply lower budgetary revenues as with other forms of evasion, but the net impact on the budget is the same in the end. Dealing with VAT refund fraud is no different than dealing with any other tax evasion.

According to Harrison and Krelove (2005) large amount of VAT revenue is lost as a result of VAT refund abuse. Registered taxpayers may not pay the correct amount of VAT for a number

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

of reasons including error, deliberately understating their VAT liabilities, or through systematic attacks on the VAT refund system.

Feria and Schoeman, (2016) noted, VAT fraud is common practice in many African countries. The effects of fraud go beyond the obvious loss of tax revenues to those; it creates equity concerns and an uneven playing field for honest businesses and it is often associated with organized crime. Whilst fighting fraud requires an intensive policy, encompassing various measures, legal design can significantly contribute to an increase in VAT compliance in developing countries through the introduction of measures that reflect a mixture of positive and negative incentives.

IMF, (2009) study experience also shows that tax authorities in a number of transitional and developing countries have often shown reluctance to embrace, fully, risk management approaches to processing VAT refunds. The authorities are simply not convinced that these methods provide adequate safeguards in environments where there is a weak culture of paying taxes. For this reason, tax administrations in these environments continue to pursue approaches designed to exercise tight control over taxpayers and their transactions.

As Feria and Schoeman (2016) stated, incentive for traders to ensure that suppliers provide invoices ensures that VAT is to some extent self-enforceable, it is also true that this self-enforceability is somewhat illusory. This is primarily for two reasons: this incentive is only present where the acquirer is a business registered for VAT purposes, but not where it is a final consumer or a non-registered business; also, even for registered businesses, who have the incentive to request the invoice, this incentive does not extend to ensuring that VAT has actually been paid. It is precisely through these two gaps that fraud has spread.

ITD, (2005) noted, the risk of fraudulent claims is often cited by tax authorities as the main reason for auditing all claims and delaying payment of refunds. In several countries, particularly those with a weak tax administration and inadequate experience with modern risk management practices, the authorities pursue time-consuming and labor-intensive processes to verify claims before approving refunds, resulting in backlogs of refund requests and considerable disquiet among businesses that have been deprived of their working capital. The author also states in contrast, the most advanced tax administrations tackle refund-related fraud as part of a broader

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

VAT compliance strategy based on risk management principles, and generally limit pre-refund verification checks to high-risk claims.

According to Bodin and Dpaizan, (2009) noted, the level of refunds is largely dependent on external factors such as the degree of development and openness of the economy, a review of the refund practices in Africa shows that there is room for significant improvement in most countries. The most frequent shortcomings in these countries are the following: – lengthy refund procedures. Refunds are sometimes delayed by more than a year; – unnecessarily complex procedures, including, the requirement to attach copies of previous VAT returns, purchase and sales invoices, and import declarations to the refund application form; – lack of basic tools and methods to assess the risks, beginning with a basic distinction between refund claims made by legitimate exporters with a good compliance history and other claims; and – due to the lack of basic risk analysis, These leads all VAT refund claims are systematically subject to audit.

Gijsbert Bulk, (2017) noted, because tax is collected and remitted by businesses, the VAT/GST system can be vulnerable to fraud and manipulation by dishonest traders. However, in addition to legislative provisions, substantial improvements in the processing of VAT refunds require development of more effective audit programs based on risk management. In Africa despite encouraging initiatives, progress in this area has generally been much slower than expected, So further improvements in audit procedures and the processing of VAT refunds will undoubtedly be essential for a substantial improvement of the VAT efficiency in these countries.

The nature of VAT fraud and evasion is similar across countries, but the methods used to tackle it may differ (Harrison and Krelove, 2005). Countries employ a range of methods to address refund abuse and VAT evasion. As study experience Some countries (e.g., Hungary, New Zealand, and the United Kingdom) apply methods grounded in risk management principles, while others (e.g. Azerbaijan, Bulgaria, China, and Korea) seek to influence or control taxpayer behavior through more intrusive systems and regulations applied to all VAT taxpayers, good and poor compliers similar.

Tax administrations maintain their focus on the longer-term strategic goal of creating sustainable tax systems based on voluntary compliance, using self-assessment and risk-management principles. There is a risk that most of these quick-fix, ad hoc solutions are incompatible with these strategic directions, as well as with the fundamentals of the VAT.

### 2.1.3. The VAT Revenue Performance and Measurement Schemes

The conventional conclusion of USA aid report noted that VAT is the most economically desirable and administratively effective way in which to collect a given share of national income through a general consumption tax that the capacity exists to administer VAT adequately. When a country introduces VAT, whether to replace another form of general sales tax or as a new tax, there need not necessarily be an aggregate increase in revenues (either from consumption taxes or in general). All else equal, however, the economic cost of collecting revenues will decline simply because the base is broader, thus making society better off (Keen, 2013).

In a subsequent update of this analysis, ITD (2005, 11) cautiously concluded that there is some evidence that the presence of a VAT has been associated with a higher ratio of general government revenue and grants to GDP. Perhaps the most important point noted in ITD (2005) in this respect, however, is the extreme variation across countries in the revenue performance of VAT, reflecting a very wide range of factors including differences in tax design, differences in economic environment, and different characteristics (e.g. literacy) in different economies. Definitive answers with respect to VAT's revenue impact are, it seems, considerably more difficult to come by than the simple assertions that characterize political debate everywhere in glob.

Theory of a recent review by Crawford, Keen, and Smith (2010), suggests that rate differentiation can play significant role in simplification distortions to market participation and (especially where better targeted instruments are weak) pursuing distributional objectives. In practice, however, it is hard to identify desirable forms of differentiation (beyond those handled by excises), while differentiation is costly to administer and comply with, and opens the door to special pleading.

As Acharya, (2016) noted on his study noted, OECD economists have long supported the view that, all things being equal, a broad based and single-rate VAT is the preferred tax approach for growth and equity. In its 2010 Green Paper on "The Future of VAT" the European Commission suggests that a broad-based VAT system with a single rate would be quite close to the ideal of a pure consumption tax that minimizes compliance costs. Moreover, many countries justify reduced rates as a way of not penalizing the poorest households for buying daily essentials since these households have high marginal propensity to consume especially food and clothing. A

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

single VAT rate with some compensatory measures targeted to the poorer households would be an ideal strategy in protecting the interest of the poor.

Multiple rates of taxation made the tax management complex and discretionary powers of the officers were frequently misused. As example Bangladesh VAT has nine reduced rates along with one standard 15 percent rate and one zero rate. In this way, there are a total of 11 rates and this has invited a series of considerations for improvement.

According to Bird and Gendron (2006) the capability of VAT in developing countries is questionable as a result of the poor administration and effective utilizing of the taxing system. Together with the low infrastructural facilities of technology useful for VAT collection and the poor administration of the tax system in developing countries, VAT has numerous difficulties.

Farther, Keen and Lockwood (2010) states that in generally developing and transitional countries with a VAT raise more revenue than those without, all else equal, though the likely gain varies with countries' openness and income levels (being less, for instance, in smaller countries, presumably because tariffs are then an easy revenue source, and perhaps lower in sub-Saharan Africa than elsewhere). As stated earlier transitional economy, VAT system generate low tax revenue when compared to that in other low-income countries in Europe, which may imply VAT administration require openness in order to attain its objectives to finance government budget and to sustain the economic growth.

A central claim made by advocates of the VAT is that it is a particularly efficient form of taxation has that actually proved of revenue. One way of testing for this is to ask whether, all else equal, countries with a VAT raise more revenue, overall, than does that without. In many countries, revenue from the value-added tax (VAT) is a major source of government revenue, making it important to understand the yearly performance of VAT revenues.

There are fairly developed measures to compare VAT systems and better understand a VAT system i.e. C-efficiency ratio and VAT productivity ratio. These measures are however limited in not considering the VAT capacity of a country. These measures have been used in many studies to investigate compliance and enforcement issues. They have been used as instruments for: (i) understanding the cross-country determinants of VAT compliance (Aizenman and Jinjarak, (2008); De Mello, (2009); Gebauer et al., (2007));

(ii) Comparing VAT compliance across countries (Jack 1996, Bird and Gendron 2007, OECD 2008); (iii) Comparing country-specific VAT compliance over time (Jack, (1996); Gebauer et al.

(2007); Hybka, (2009)); (IV). Determining the optimum VAT rate (Matthews, 2003); and (v).evaluating the effect of VAT reform models on VAT evasion (Gebauer et al., 2007) instrument.

However, the responsiveness of the C-efficiency ratio and VAT revenues to the state of the business cycles can reflect several factors, and the magnitude of the effect can vary over time and across countries. Therefore, to diagnose the VAT revenue performance appropriately for a specific country, it is critical to look closely at its particular past experience and that of countries with similar characteristics.

According to M. Keen (2013), there are two measures of VAT revenue collection efficacy most commonly used are: cross-country and cross-time studies, such as VAT productivity (VP) and VAT collection efficiency (CE). These measures used to investigate VAT characteristics and compliance deviations from one country to other or from time to time in one country. The measures are often interpreted as a measure of non-compliance due to tax evasion, tax fraud and administrative inefficiency or laxity.

### **2.1.3.1. Collection Efficiency (C-efficiency)**

The Collection Efficiency (C-efficiency) ratio is the most commonly used indicator for evaluating the revenue performance and overall efficiency of the VAT system. It is simply the ratio of actual revenues to theoretical revenues from a perfectly enforced tax levied at a uniform rate on all consumption (Ueda, 2017).

‘VAT efficiency’-sometimes called ‘C-efficiency’-has come to be used as a more reliable indicator of comparative VAT performance. This figure is calculated as the ratio of VAT revenues as a percentage of (usually private) consumption divided by the standard rate, so it has a unit value for a uniform tax on all consumption. The idea of C-efficiency has proved very attractive to applied policy analysts: calculating it, and making comparisons with other countries, is a core element in much of the advice commonly given to developing countries, and is now routinely reported for its members by the OECD. One practical merit is that the data requirements for putting some number on C-efficiency are relatively modest. And these numbers can provide a vivid first assessment and expression of the potential revenue gain from base-broadening (Keen, 2013).

According to Sokolovska and Sokolovskyi (2015) tax exemptions tax incentives and zero-tax rates could be considered one of the main reasons of administration complexity, which in turns

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

avored to the growth of the shadow sector and the level of corruption. These negative factors can be diminished considerably by an effective VAT administration. Commonly it implies the minimum difference between estimated and actually collected tax revenue. I.e. it is referred to the tax compliance. In turn the estimation of VAT efficiency can provide the necessary information concerning level of VAT compliance in given country in order to determine the directions of improving of VAT administration.

There are, however, both the conceptual and practical issues to be faced in using C-efficiency to assess VAT systems. Conceptually there is no deep welfare basis for the use of C-efficiency in assessing a VAT. Reforms that bring a VAT closer to the benchmark of 100 percent C-efficiency do not necessarily mean a better VAT. C-efficiency can be increased, for example, by denying VAT refunds to exporters, or by introducing exemptions for intermediate goods; there may or may not be other good reasons to do so, but the effect is in each case to undermine the intended role of the VAT as a tax on domestic consumption. One implication is that a base-broadening reform that increases C-efficiency without changing the standard rate must reduce deadweight loss by more than it reduces welfare. But that is not a very powerful observation (Keen, 2013).

Advantages of VAT efficiency measure are: easy to calculate, comparative basis within and between countries, fairly good approximation of VAT base and identify good and bad VATs. While its limitation includes: bias for importing countries, some poor practices can increase c-efficiency, some good practices can decrease c-efficiency and does not identify what is driving VAT gap (IMF, 2015).

### **2.1.3.2. VAT Productivity**

VAT productivity is simply the ratio of VAT revenue to GDP divided by standard rate of the VAT. The computation indicates a per cent of GDP at each percentage point of the standard VAT rate collects. It is a crude measurement of VAT efficiency, but nevertheless indicates the percentage of GDP collected by each percentage point of the standard VAT rate. In general, higher ratios indicate better the performance of the VAT. However, this measure may be quite misleading in an important sense since in principle VAT usually taxes consumption, not production, and GDP measures production, not consumption.

Advantages of VAT productivity measure is easy to calculate and Comparative basis within country. While its limitation includes: VAT is not a tax on production, GDP does not capture the

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

VAT base, VAT rate influence measure greatly and does not identify good and bad VATs i.e. Controlling for the rate will improve measure (IMF, 2015).

$VP = \text{VAT revenue} / (\text{GDP} \times \text{standard rate})$ .

The VAT compliance literature identifies a number of limitations to both VP and CE measures. One limitation, easily corrected, is that the VP and CE indices do not exclude the VAT itself from their final consumption base. Another obvious shortcoming of all two measures (CE and VP) is that in calculating potential revenue, they use only one standard VAT rate. This is despite many countries having multiple rates, and with these rates often varying considerably.

IMF, (2013) noted, using the VP and CE measures to investigate VAT characteristics and compliance deviations from one country to other or from time to time in one country the measures are often interpreted as a measure of non-compliance due to tax evasion, tax fraud and administrative inefficiency or laxity. And somewhat suspect international comparisons may be misleading, however a more useful way to use such ‘performance indicators’ may be to view a country’s performance over time.

Keen (2013) also points out that volatility in the C-efficiency ratio have been more influential than the changes in the standard rate and final consumption ratio to GDP for the evolution of overall VAT revenues in many countries. The C-efficiency ratio measures VAT in terms of consumption and is calculated by taking the proportion of VAT as a share of consumption divided by the standard VAT rate. This statistic is a more reliable measure of VAT performance than the VAT efficiency ratio as it is based on consumption rather than GDP. Since VAT is a tax on consumption. Sancak et al. (2010) noted that C-efficiency has been significantly affected by both short-term behavioral changes, such as in consumption patterns, and the short-term fluctuation of taxpayer compliance, along with business cycles.

## 2.2. Empirical Literature

According to the researcher knowledge, there are some researches done on VAT refund and revenue performance issues with different titles among them: In countries like Ethiopia, capital goods are treated in the same way as other merchandise items (Yesegat, 2008). Such a custom affects mainly taxpayers that are required to carry forward credit claims including those on capital goods to future periods. This procedure impacts negatively on investment.

A study of VAT Administration and Revenue Performance: Challenges and Opportunities in the Mekelle Branch of the Ethiopian Revenue and Custom Authority (ERCA) by Gebre-Egziabher

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

(2010) conclude that in the process of VAT administration and revenue generation, different problems were observed, the main ones being attitudinal problem of the tax payers and implementation capacity of the government employees. Changing the attitude of the taxpayers and building the implementation capacity of the employees of the branch office are some of the important recommendations made by the study.

A study Edmiston and Bird (2004) in countries like Ukraine argued that many of the problems with VAT arise from the refund system. In 2004, for example, new refund claims in Ukraine amounted to 41% of collections. A recent study of 28 countries of refund levels for the 1998-2001 period found that nine countries had ratios in excess of 40%, with an average for the seven transition economies included in the study of 36.8%, so Ukraine's ratio does not seem out of line (Harrison and Krelove, 2005).

A study of VAT refund in developed and developing countries by Bird and Gendron, 2005 resulting, tax refunds are not only legitimate in the sense of being related to legitimate business inputs but also the taxes for which reimbursement is being claimed have actually been paid even in a countries with well-established and experienced tax administrations such as Germany so much fraud has been uncovered in the form of illegitimate invoices that it has recently been proposed that refunds should not be paid unless satisfactory proof that the input taxes claimed have been received by government.

Another study by Kadenge, (2012) noted, Cross-country experience indicates that delay in tax refunds is common in developing countries. The delay is generally derived from inefficient processing of refund claims and strong incentives for meeting revenue targets on the part of the tax administration and from the risk of large-scale abuse on the part of taxpayers. In addition, the treasury is under pressure to postpone the refunds during budget-crunching periods.

A study of VAT in Francophone Africa by Waezeggers, cited in Krever (2008), shows that for Algeria, excess input tax credits must be carried forward to the following tax periods until entirely written off. VAT refunds are only granted to exporters and to suppliers whose output is taxed at a lower rate than their inputs. A study in Tunisia indicated that up to 50% of excess input tax credits may be refunded after they have been carried forward for six consecutive months. In Madagascar, excess input tax credits must also be carried forward to the next tax period. Burkina Faso refunds excess input tax credit only to exporters and to businesses that

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

cease operations (Krever, 2008). Mali and Niger limit refunds to exporters to an amount equal to 60% of the VAT that would have been payable on the exported goods if they would have been supplied domestically.

In a study carried out by Harrison and Krelove (2005) on title VAT Refunds: A Review of Country Experience. The paper examines the refund approaches of tax administrations in 36 developing, transitional, and developed countries. It evaluates the effectiveness of these approaches and suggests a model of best practice that takes into consideration compliance issues faced by countries during different stages of development. It was concluded that there is problem in VAT refund processing, that is sometimes a tendency for tax administrations to deviate from the primary goal of building sound VAT systems based on improved voluntary compliance through effective systems of self-assessment.

Sokolovska and Sokolovskyi (2015) study on the VAT efficiency in the countries worldwide, asserts that in a large part of developing and transition countries VAT performs primarily fiscal function, being the main source of budget revenue a large amount of revenue is lost as a result of VAT refund abuse. At the same time the shadow economy particularly in form of corruption and tax evasion that exists in these countries leads to a considerable tax gap which in turns reduces VAT efficiency.

Badalyan (2008) study on VAT refunds in Armenia. The economic policies of various countries witness the importance of the VAT refunds. In any memorandum concerning the economy growth reforms there is a special provision which is stated that the government undertook to enact the legislation to prevent further accumulation of VAT refund arrears. Therefore, VAT refund is the one of the key features for economy growth. In any memorandum concerning the economy growth reforms there is a special provision which is stated that the government undertook to enact the legislation.

While most-but not all-developed countries make timely refund of excess credits, many developing and transition economies with less developed tax administrations often limit the entitlement to VAT refund. In that weak tax administration and associated compliance issues are a major contributing factor, and that increasing awareness of the risks of fraud has led to departures from the theoretically ideal practice of immediate refunding. To this end a measure adopted by many countries is to impose a mandatory carry forward period for excess credits.

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

This means that a refund is paid only if an amount of excess credit remains to be recovered by the taxpayer at the end of the carry forward period (ITD, 2013).

Krelove and Harrison (2005) noted, most developed countries, including New Zealand, Japan, Canada, and EU countries, allow for complete refund of all excess tax credit, while developing countries often embark upon a hybrid system of refunds and carry-forward arrangement of the excess credit). One proven approach to administration of VAT refunds is to establish categorizing items in which refund claimants are grouped into items and “others” categories. The criteria for the grouping must be simple and transparent, through related to the claimant’s history of exports, book keeping, tax compliance, and audit of records by tax officials. Those classified in item categories are granted with such privileges as fast, and without pre-approval audit refunds. The scheme helps tax administrations focus on checking and auditing high-risk refund claimants (AEO, 2013).

Further, study on Efficiency of a single-rate and broad-based VAT system: the case of Bosnia and Herzegovina by Antic (2014) his key hypothesis is that the high efficiency of the broad-based and single-rate structured VAT system may be neutralized by the country’s specific circumstances and VAT policy design. Applying a set of indicators for VAT efficiency analysis, developed by IMF, OECD and EU, he find a deterioration of the components of the policy gap caused by derogations of the VAT Law, and an increasing compliance gap, due to an increase of the VAT debt and tax evasion, in consequence of poor policy design in the field of excises. As a result of the influence of the country’s specific circumstances and its VAT policy design the identifiable current net losses on VAT in 2013 amount to 4% of net VAT collection or 0.4% of GDP.

Recent studies provide information on the level of VAT refunds and practices in the area (including refund procedures, processing delays, approaches developed to deal with the risks of fraud.) have resulted in a classification of the VAT systems of certain regions and countries. The studies confirm the difficulties faced by most African tax administrations in making refunds of excess input VAT to legitimate exporters. The level of refunds (as compared to total gross VAT receipts) was less than 10% in Africa in 1998-2001, against 35% in the OECD countries and 17% in Latin America in the same period (OECD, 2017).

In a study carried out by Legeida (2002) in Ukraine, it was concluded that the VAT refund problem lies not only within VAT legislation and administration, but rather touches on a broad

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

range of fiscal and economic issues. Fraud was pointed out as one of the elements and government was said to have lost vast amounts of resources through non-cash sales and settlements. In addition, numerous preferences (tax incentives) such as zero rates were said to have eroded the tax base and further resulted in fraud and corruption. In Ukraine, Legeida & Sologoub (2003) concur with the notion that VAT problems arise both within VAT legislation and VAT administration and also on a broad range of fiscal and economic issues. The study highlights that numerous preferences (incentives) such as zero rates and exemptions have eroded the VAT base and resulted in fraud and corruption.

Harrison and Krever (2008) assert that a large amount of revenue is lost as a result of VAT refund abuse. Even in countries with well-established and experienced tax administrations such as Germany, so much fraud has been uncovered in the form of illegitimate invoices that it has been proposed that refunds should not be paid unless satisfactory proof is provided that the input taxes claimed have been received by government (Sinn et al., 2004).

### **2.3. Conclusion and knowledge Gap**

VAT refund practice is a current issue for both developing and developed countries which directly attached with the design of VAT. There is no sufficient theory regarding VAT refund activities and revenue performance. In the theoretical review, to the knowledge of the researcher, there is no standard as to the percentage of VAT refund methodologies to be conducted in a given tax authority (vary depends country VAT law). In addition, there is no adequate literature regarding the appropriate sales and purchase invoice examination techniques to be used for checking the accuracy of refund claim in line with the level of economy and technological advancement, developing countries in particular.

However, the literature review attempted to present the existing evidence on VAT design features and administration, refund and issues in VAT refund. It also presents VAT revenue performance measures along with their limitations. The empirical studies that have been reviewed in the preceding section focused on the evidences on VAT refund practices, and VAT revenue performance. To the knowledge of the researcher, most of these past studies focused on the VAT refund experiences of some group of countries such as a review of country experience on VAT refund practice and revenue performance was conducted by Harrison and Krelove (2005) and Sokolovska and Sokolovskyi (2015) and Keen (2013) respectively have analyzed for

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

a group of countries there are no studies that examine the VAT refund practice and revenue performance in dial of specific economy.

However, from these studies, it is not been possible to inquiry the details of the VAT refund practice and revenue performance within a particular country. In the context of Ethiopia, there appears to be limited evidence on VAT refund practice and VAT revenue performance. This study hence intended to fill this knowledge gap in the literature.

In Ethiopia, the two exceptions regarding VAT refund and revenue performance issues are the study by Yesegat (2008) and (2016) and Gebre-Egziabher (2010) which have been reviewed in the preceding section. Even these studies did not assess exhaustively all VAT refund activities in Ethiopia. The study by Yesegat (2008 and 2016) was VAT administrative capability and Value Added Tax withholding issues respectively in Ethiopia which is specific to refund claim types. The study by Gebre-Egziabher (2010) was specific to Makele branch of ERCA on VAT Administration and Revenue Performance that mainly focused on the overall VAT administrative issues and way of increasing government revenue.

To the knowledge of the researcher there appear to be limited evidence on VAT refunds and revenue performance. So this study is more specific and concentrates on the essence of VAT refund practice and revenue performance in Ethiopian. Both of the study studies did not comprehensively examine issues regarding problems on VAT refund operations, in respect of the appropriateness of document verification and time to refund pay, type of refund claims and its legal framework, cause for VAT refund, trends of VAT refund and revenue performance in Ethiopia focusing on federal government and overall VAT refund practice and revenue performance and compliance improvement by considering issues such as refund fraud investigations, and its suitability, appropriate case selection approaches.

Based on the above listed available previous researches; gaps in the literature together with the problems stated in section 1.2, the following grand research question is established. “How is the VAT Administration practices, focusing on VAT refund procedures and revenue performance in ERCA by the case of Federal Government In Ethiopian Tax System?” With this end, the next chapter discusses; the research design and specific research methods that are applied for the study along with proper justification for the selection of appropriate research methods.

## CHAPTER 3-RESEARCH METHODOLOGY

Methodology is the sciences and philosophy behind in all research and a set of methods, rules, or procedures used in conducting and implementing research (Creswell, 2014).

This chapter discusses the methodology of the research. Section 3.1 presents the nature of research objective and research questions while section 3.2 research approaches, section 3.3 research approach planned to be used in this study 3.3.1. Qualitative aspects of the research 3.3.2. Quantitative aspects of the research and finally section 3.4 were conclusion.

### 3.1. Research objective and research questions

As indicated in the first chapter the broad objective of this study is to assess VAT refund practice and Revenue performance in Ethiopia. This broad objective farther spilt into the following specific objectives/research questions (RQ).

*RQ1. How is VAT refund legal framework in light of experiences in other countries?*

*RQ2. What is VAT refund procedures employed in processing and refunding excess VAT credits in Ethiopia?*

*RQ3. What are VAT refunds related challenges the tax administration and taxpayers are facing?*

*RQ4. What are the causes for VAT refund claims in Ethiopia?*

*RQ5. How is VAT revenue performance in Ethiopia?*

### 3.2. Research approaches

As Creswell (2014 p. 295) noted, Research approaches are plans and the procedures for research that span the decisions from broad assumptions to detailed methods of data collection and analysis. It involves the inter section of philosophical assumptions, designs, and specific methods.

There are three alternative strategies of inquiry: qualitative, quantitative and mixed approaches. These approaches are different in terms of their philosophical assumptions as well as techniques used in data collection, analysis and interpretation and are discussed in the subsequent paragraphs.

**Qualitative research approach:** explores attitudes, behaviors and experiences through methods such as in-depth interview and/or focus group discussion (Dawson, 2002). As Cooper (2006) noted, qualitative research method is used when the focus of the research is to understand and

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

interpret rather than describing, explaining and predicting variables. The researcher collects open-ended emerging data with the primary intent of developing themes from the data (Creswell 2007). It is capable to generate a theory by addressing issues which cannot be quantified. Qualitative research method **aims to achieve an in depth understanding of a situation**. It has been criticized for lack of scientific rigor, small samples, subjective, non-replicable efforts and the researcher's interference in the research process is very high.

**Quantitative research approach:** generates statistical data through the use of large scale survey research, using methods such as close-ended questionnaires and/or structured interviews (Dawson 2002). Creswell (2009) noted that quantitative employs strategies of inquiry such as experiments and surveys and collect data on predetermined instruments that yield numeric data that can be analyzed using statistical procedures. It is a means for testing objective theories through examining the relationship among variables. It is advantageous as it, procedurally, follow scientific approach, tests reliability and validity of the instrument. It minimizes bias from the researcher's influence and employs large sample size. Hence, the results can be believed on and the results can be generalized to larger population. However, **it is not capable to address issues which cannot be quantified**. So that, it has limited scope.

**Mixed research approach:** combination of both qualitative and quantitative approaches. As cooper (2006), most researchers recognize that qualitative method compensates for the weaknesses of quantitative methods and vice versa. The data collection involves gathering both numeric information and text information (Creswell, 2009). Looking at the research problems and the philosophy of the different research methods together with mixed method of study. In this triangulation, both qualitative and quantitative methodologies were used to increase the perceived quality of the research. However, incorporating both designs requires a great level of effort from the researcher such as need for extensive data collection. Mixed approach characterized by its time-intensive nature of analyzing both numeric and text data.

### 3.3. Research Approach adopted

Research methods are the techniques used to collect data. In this study, the researcher adopted **mixed** methods approach, as discussed in the previous section, which is employed concurrently in collecting and analyzing data. There are different tools available to the researcher to collect the required data including observation, interview and document analysis. For this study, the

# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

researcher applied qualitative (observation in the working area, in-depth interview and document analysis) and quantitative approaches (used data related to VAT revenue performance and refund trend) are discussed in the following sub-sections.

## **3.3.1. Qualitative aspects**

Qualitative research is used to describe or explain what is happening within a study area. The purpose of adopting qualitative research approach was too deeply understand the design, practice, cause to VAT refund and key problems of VAT refund in Ethiopia. The qualitative component employed in-depth interviews and documentary review. The subsequent sections present the in-depth interviews and documentary analysis.

### **In-depth interview**

This study applied in-depth interview to explore the data that is unclear for the researcher and the information that have not been collected through survey and document analysis by allowing the interview to remain flexible.

To determine the sample size no formula exists in qualitative research. There is a tradeoff between depth and breadth, given limitation of time and money (Patton, 2003). Thus, in-depth interview was conducted with 18 tax collectors (15 from the three branch offices and 3 from head quarter).

In addition to the above respondents the researcher interviewed three (3) taxpayers from the three branch offices who have experience with the VAT refund system. The researcher also considers the type of taxpayers who involved from different types of VAT refund claims include: one from export business sector, one from VAT withholding agent and one from regular VAT refund claims. In this regard the researcher visiting taxpayer's offices at different time by asking their willingness through telephone. With the intent of gathering information that needs clarification and that cannot be achieved through other techniques. In order to obtain experienced and concerned respondents the researcher perform in-depth interview with selective tax collectors at each branch level at different time and place.

### **Documentary analysis**

As Creswell (2009) noted, use of documentary analysis has its own strengths and limitations. The strengths are enable the researcher to obtain the language and words of participants, can be

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

accessed to the researcher at a time conveniently, represents data which are thoughtful (participants given attention when compiling them) and economical (it saves the time and expense of transcribing). Whereas, the limitations include incompleteness, lack of accuracy (the documents may not be authenticated), requires transcribing or optically scanning for computer entry, not all people are equally articulate and perceptive and may be protected from private access.

In addition to the data obtained through other methods, this study employed a descriptive analysis of the document data (revenue and refund related data) that was obtained from the Ethiopian Revenue and Customs Authority (ERCA) and the Ministry of Finance and Economic Cooperation (MoFEC). Of documents such as periodical VAT refund reports and collection, VAT proclamations and regulation, tax refund directives, overall consumption and other documents that are relevant for the study. The document analysis is applied for examining the level of VAT refund request in a given fiscal year, the VAT revenue performance over period, the background information of the study area and as a supportive for other VAT refund activities in Ethiopian tax system.

### **3.3.2. Quantitative aspect**

The purpose of using quantitative approach in this proposed study was to assess VAT revenue performance and the trend in VAT refund in Ethiopia.

The study employed data sourced from the Ministry of Finance and Economic Cooperation, Ethiopian Revenue and Customs Authority and other sources. In assessing the revenue performance of VAT, the study employed such data as annual VAT refund and revenue, Gross Domestic Product and consumption expenditure.

These also were supplemented by data that were obtained through interviewing selected tax officials and taxpayers who are affected by the VAT refund scheme. Both cases help the researcher to analyze gathered, valid and reliable data that are relevant to achieve research questions and objectives.

The document analysis, the researcher attempts to show the trends of VAT refund practice and measures used to assess the performance of VAT revenue (the C-Efficiency ratio).

The researcher also adopted C-Efficiency estimation from existing alternatives. However, VAT is a tax on consumption and is calculated by taking the proportion of VAT as a share of total

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

consumption divided by the standard VAT rate. This statistic is a more reliable measure of VAT performance than the VAT productivity ratio as it is based on production (GDP) rather than consumption (Keen, 2013).

$$E_f \text{VAT} = \frac{\text{REVVAT-act}}{\text{REVVAT-est}} \times \frac{1}{\text{Cons}} \quad (1)$$

Where: REVVAT-act and REVVAT-est. denote the actual and estimated VAT revenue respectively and Cons is the final total consumption as % of GDP; vat is the standard VAT rate.

### 3.4. Conclusion

In this chapter, research methodology options available to a researcher including qualitative, quantitative and mixed method approaches, each using different knowledge claims, strategies of inquiry and methods of data collection and analysis are discussed. The link of research questions and research methods adopted in this particular study is also presented with proper justification in method selection in line with the strength and weakness of each research method.

Mixed research design is opted for the study that helps the researcher to achieve the research objectives and the required data is collected through close observation, in-depth interview and documentary analysis.

## CHAPTER 4- RESULTS AND DISCUSSION

In the previous chapter, the research methodology has been discussed. And this chapter presents the result and discussion of the data collected using different methods. The chapter is organized in three sections. The first section (section 4.1) presents the broad research objective and specific research questions. This is followed by results and discussions in the second and third sections respectively.

### 4.1 Research objective and questions:-

This section presents research objective and questions in order to relate them with the findings of the study as presented in sections 4.2 and 4.3. The main objective of the study was to investigate the VAT administration practices focusing on refund procedures and revenue performance.

Based on the above broad research objective the following specific research questions (RQ) were developed:

*RQ1. How is VAT refund legal framework in light of experiences in other countries?*

*RQ2. What is VAT refund procedures employed in processing and refunding excess VAT credits in Ethiopia?*

*RQ3. What are VAT refunds related challenges the tax administration and taxpayers are facing?*

*RQ4. What are the causes for VAT refund claims in Ethiopia?*

*RQ5. How is VAT revenue performance in Ethiopia?*

### 4.2. Results

This section presents the results of the study based on data solicited through in-depth interviews and document reviews and also assessment VAT revenue data.

#### 4.2.1. Results of In-depth interview and documentary reviews

In order to answer the research questions and achieve broad objective, data was gathered from different sources. Results of in-depth interviews, review relevant documents and assessment of revenue data are presented in the subsequent discussions. As presented in chapter 3, fifteen (15) tax officials and three (3) taxpayers were interviewed. This section presents the results of interview and document review on VAT refund procedures employed in processing and refunding VAT credits in Ethiopia. The following paragraphs present the results in respect of

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

VAT refund procedures, VAT refund claim types, challenges of dealing with VAT refund claims, among others.

### **VAT refund procedures (in processing and refunding excess VAT credits) in Ethiopia**

According to the in-depth interview of tax officials- ERCA made VAT refund mainly in federal domestic branch offices. The legal framework of VAT refund administration in Ethiopia shows, when input VAT exceeds output VAT the amount should be paid as a refund to a registered business organization within the time period stipulated in the VAT law.

Article 27 of VAT proclamation No. 285/2002 as amended provides that taxpayers with at least 25% zero rated transactions are allowed to get cash refund within 30 days from the day the VAT refund claim is filed. On the other hand, businesses that do not meet the above criteria of at least 25% zero rated transaction are required to carry over their excess VAT credit to the next five taxes accounting periods (five months) and offset them against their VAT liabilities. In addition to this if the VAT refund claim arises from the VAT withholding scheme, tax payers are legally allowed to get their refund claims within 60 days from the date their refund claim is filed.

In all the above cases cash refund is payable only when the refund claim is more than ETB 50. Before making refund payment the Ethiopian Revenue and Customs Authority process the claim checks its reliability of the claims through conducting audits of various levels (desk audit to comprehensive audit). The time ERCA takes varies from 7 days to years. For some taxpayers the refund process is very fast while for others it might take very long time.

Regarding budget for VAT refund, the Proclamation number 285/2002 article 4 empowers MoFEC to determine the amount of VAT revenue retention for VAT refund, Accordingly, as interviews with tax officials show MoFEC issued the first VAT revenue retention directive in 2004 which allowed 5% to retain from total collected VAT revenue. This was revised to 10% in 2016 due to shortage of cash with increasing refund request, now for the same reason it revised VAT refund retention up to 15% from gross VAT revenue collected.

As the data in ERCA shows the number and volume of VAT refund requests is increasing from time to time. However, the tax authority made refund after any tax liability offset and only if an amount of excess credit remains at the end of the carry-forward period. This increment creates delay in processing refund requests and imposing burden on both taxpayers and tax

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

administration. The VAT law set, if the authority does not pay the refund on the specified date, it will pay interest now is 15% over and above the highest commercial lending interest rate prevailed during the preceding quarter

Regarding VAT refund trend, table 4.1 under appendix 3 shows the types of VAT refund claims, the periodic VAT refund claims, approved, rejected and paid are covered and we can also observe, VAT refund claim increase from year to year and VAT withholding refund claim take the largest proportion among other types of refund claims. Farther, the document analysis shows, both VAT refund requests and VAT refund payment in the three branch office of ERCA were continuously increasing. For instance the total number of refund request in the year 2016 at three branch office of ERCA from advance paid tax ETB 13,684,439,392.53 Refund claim were applied. Out of this ETB 8,125,716,235.71 (Which is 62%) were approved to refund. In addition 239 million were offset for existing tax liability, ETB. 2,103 million were not processed due to unfulfilled document and ETB 1,569 million was transferred for the next fiscal year.

At the same time, the share of VAT withholding refund claim from total VAT refund is increasing and it scores in average more than 60% as stated reputedly. From the three branch office, LTO score the largest number of VAT refund claims than the other branches followed by East branch office, finally West branch office of ERCA. The annual report of ERCA shows, a huge figure of VAT refund claims are usually rejected because of illegal invoices, repeated request claims, missed document and the issue of fraud. The following table summarized this.

**Table 4.2 VAT refund pay as % of gross VAT claims and large refund claim type in the three branch office of ERCA**

FY	2010	2011	2012	2013	2014	2015	2016
Total VAT refund request in the study area	1,832,740,387.98	3,054,375,833.44	7,154,170,898.42	5,266,773,944.27	7,468,366,458.36	31,955,287,997.13	13,684,439,392.53
Refund pay as a % claimed	66%	65%	59%	40%	68%	78%	62%
Share of VAT withholding claim	27%	23%	22%	62%	86%	66%	65%

**Source:** annual report of three federal branches of ERCA

From the above table we understand there is unexpected fluctuation on VAT refund claim in the three branch offices of ERCA, for instance in the year 2013/14 refund request is decreased due to

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

the two public enterprise (Ethiopian Electric Power and Ethiopian Railway corporation) are allowed to use VAT withholding rather than Applying VAT refund claims for VAT paid on the expansion of their projects and Condominium Housing Projects refund claims are also transferred to Addis Ababa sub city government tax authority since, it is served at Eastern and Western branch of ERCA.

Farther, the share of VAT withholding increased among eight categories of VAT refund claims, the share of VAT paid and VAT refund requested were increased in Federal branch offices of ERCA due to huge VAT refund claim also applied by construction company next to VAT withholding.

The pre request for overall types of refund claims which mentioned blow includes: first, taxpayers should be issued refund claim letter to ERCA (refund processing department) then the letter would be registered as memorandum and assigned to tax officers for valid examination. Based on this letter the refund procedure was under taken. Since taxpayers are expected to comply with their VAT obligations with limited intervention of tax authority. The procedures are achieved through a system of self-assessment. Where taxpayers have access to the information and support from the tax administration and calculate their own liabilities and claim refunds that they assessed. According to the interview of tax officials, if they fail to make accurate assessments, pay insufficient tax and false claim for refunds they obliged to be audited and subjected to penalties.

So the tax authority required to check the transaction invoice seriously to avoid any doubts that made during the examination of the document. These document issued by a business organization is kept together with the record of payment for further reference and submitted on request. The document includes: any legal documents that confirm the payment, which is the payment orders, receipt of bank account; declarations, all the contracts with the suppliers and the consumers, accounting documents of the suppliers (invoices, tax accountings, etc.); customs declarations of importing goods.

Finally, if there is approved payment for taxpayers the finance department of ERCA taking into account the approval of the refund processing department remits money to the taxpayer bank account or offer check with specific business organization or taxpayer name. Otherwise the cases were transfer to investigation department if there are doubts on examination of the document.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

**Classification of VAT refund claims:** -according to document review, in Ethiopia the Federal branch offices of ERCA categories taxpayers into two, zero rated businesses (mainly export) and others (non-exporting) businesses. However, VAT refund practice in ERCA shows different VAT refund claims are performed among others: export (zero rate and AEO), regular VAT claim, VAT withholding claim, capital expenses, especial privileged institutions (embassies, diplomatic missions, some specific non- government entities and multilateral agreement for VAT exemption among countries) and condominium housing project VAT refund.

**Zero rate business:** - as expressed above the VAT law allowed refund to the business if at least 25 percent of the value of taxable transaction of a registered person for the accounting period is taxed at a zero rate. The Authority shall refund the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within one month after the registered person files an application for refund. So the document should be approved by tax officer for the payment of the input VAT.

The detail process of international trade and tax incentive would be under taken by in ERCA based on proclamation No. 768/2012 (amended). In this case taxpayers should provide the necessary document from third party like bank (bank permit and credit advice), transportation Company (bill of loading/air ways bill), customs declaration and purchase invoice. VAT refund directive allow refunding within specified period after the necessary examination up on the application of refund request.

**Authorized Economic Operators (AEO) Refund Claim:** - The AEO VAT refund system was introduced in 2008 with the aim to increase foreign currency and promote investment. The system is authorized by MoFEC to pay VAT refund in 7 days after the application of refund request with necessary document which include certificate from ministry of trade.

According to Directive No. 26/2008 which issued by MoFEC that specify the procedure to fast-track VAT refund process for selected business organizations to receive an immediate cash refund. In this directive article 5 empowers the Ministry of trade and ERCA to identify those business entity with criteria: the amount of foreign currency that they bringing's to the economy and history of tax compliance. There for only 35 taxpayers were selected for fast-track VAT refund process until 2015/16. But this figure is frequently changed based on the application of entrants who meet the requirement of the above directive and some of the selected businesses are also rejected when they fail to fulfill the criteria after being selected.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

**Non-Exporting Businesses (Regular) VAT Refund Claim:** - this type of claim were occurred when there is overpaid tax or erroneously paid tax. The VAT law allowed claiming a refund after Carrey forward excess VAT credit for a five reporting period. And the legal framework includes a time limit to repay the VAT refund starting from the moment the refund was requested. The net VAT balance is refunded to the business organization only when this period ends.

**VAT Withholding Refund Claim:** -Ethiopia introduces VAT withholding system in 2009 with the aim to increase VAT revenue collections. This system is adopted to withhold VAT on the purchases of goods and services by federal, regional and city administration institutions and public enterprises.

Directive No. 27/2009 article 7 specify application of VAT withholding on transactions valued more than ETB 5,000; i.e. if the transaction is less than ETB 5,000 withholding agents are not required to withhold the VAT. Agents obliged to withhold 100 percent of the VAT and remit the amount to the revenue authorities in 30 days from the end of the month in which the VAT was withhold. Taxpayers offset the VAT withhold against the net VAT payable in a period. If the withholding VAT exceeds the amount due, the excess is claimable as refund after carrying it forward to the next two months.

**Charity Organization Refund Claim:** -are organizations that perform humanitarian assistance at the time of natural/manmade disaster. In Ethiopia there are a number of international organizations and institutions they accomplish humanitarian assistance. They are VAT exempted according to VAT law and ERCA handled the amount of VAT paid in there purchase of goods and services through the VAT refund process accordingly the directive No. 23/2008.This directive specifies application of VAT refund process on purchase of goods and services by Charity organization and limits the transaction only for intended purpose.

**International Multilateral Agreement VAT Refund Claim:** - this agreement made among country to make tax exemption on purchase by diplomats, Embassy and international organizations (also called special privileged organizations). The previously the tax center allowed domestic purchase of goods and services made by those organizations are not taxed at the begging of purchase (simply providing the letter from foreign affair since 2003 up to 2007). However, this procedure open the room for unethical practice and the authority face difficulty in tax administration as a result the ministry issued directive No. 24/2007 to allow VAT exemption through tax refund procedure.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

According to directive No. 24/2007 the authority made VAT refund within one month like other refund claims after document approve (such documents includes authorization letter from MoFEC), purchase invoice from VAT registered business organization through the use of special bank account known as Non-reserve (NR) account and the correct statement of the member of diplomatic identity card (organization member) is a requirement to made fast refund pay. Procedure for refund request includes filling in particular form prepared by the authority within the next month after transaction. But the time limit should not extend more than a year.

**Refund Claims on Capital Goods Purchase:** -it is special arrangements of ERCA to deal with credits of imported capital goods. Ethiopia made VAT exemptions for foreign investors who import capital goods, with initial investment capital more than one hundred million USD (\$100m). While the domestic investors are treated by directive No. 68/2012 amended in 2014, 103/2014 this allowed VAT deferment system. In Ethiopia most investors have the opportunity to use a tax defers to pay VAT on the imported capital items or to use bonded warehouse as a guaranty for capital goods, the details presented under directives which kept not more than 120 days.

Regarding customs related VAT collection and refund, in-depth interview of tax officials reveals a branch of customs in ERCA required to submit clear information about the decision of VAT refund that collected from imported goods. This is because of the tax center knowing the amount of VAT refund; credit the overpaid tax against any liability of that taxpayer, than the tax center made refund for the extra amount in domestic branch office of ERCA.

### **VAT Refund Related Challenges that Tax Administration and Taxpayers are Facing**

The annual report of ERCA (2017) stated, to some degree the refund procedure in ERCA takes place based on the standards. However, the authority does not give emphasis and not assign enough number and well trend refund officers for the document examination and desk audit in its overall organizational structure resulting inefficient tax administrations. Further the report stated, there is specified time interval within which taxpayers are expected to obtain their refund payment but in practice the refund request is not processed due to taxpayer's negligence to submit the required document on time and the capacity of tax center to process refund. The key problems of VAT refund in ERCA are presented in the subsequent paragraphs.

**VAT Registration:** -According to the in depth interview of tax officials the tax administration and taxpayers are facing VAT refund related challenges. This begins with taxpayer's voluntary

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

registration based on VAT law. Most registered business organizations are required to collect VAT during their sales. They raise sales price of goods and services because of VAT rate (15%) on their sales price compared to unregistered competitors. So they were rise complain on non-registered trader at various forums.

In addition even they are registered to collect VAT but same business are made transaction without issue invoices, which is the most common ways that businesses use in reducing their tax liability. The other business are sales different types of invoice for VAT refund claims by using stolen cash register machine and they registered for VAT in order to booked government revenue which may significantly disrupting the functioning of the VAT system.

**The Time to Process VAT Refund:** - According to in depth interview of taxpayers revealed that the period to process VAT refund claim takes a long time due to lack of poor invoice verification mechanism. Which may include: gathering VAT information from internal sources, additional analysis of accounting information, calculating the VAT refund amount, preparing any additional documents needed to prove the VAT refund claim and completing any other mandatory activities or tasks associated with the VAT refund claim would take long time.

According to document analysis, a guideline used in refund process of ERCA requires all refund claims to be checked in detail with documents. This may cause for spending scarce resources and required to look best mechanisms to serve taxpayers with lower compliance risk. Since, detail document verification with limited staff member would be difficult. Even through, the VAT refund process in ERCA does not completed at specific point it requires the involvement of other staff due to this a number of refund request often takes several months year to process refund claims. This cause problem to properly manage and timely VAT refund.

**Complex Procedures:** - this includes the requirement to attach copies of previous VAT returns, purchase and sales invoices, bank permit, transportation and import (customs) declarations are required with refund application form. According to the interview of taxpayer's reveal that as a result of unlimited prerequisite most taxpayers not apply refund claim for significant amount.

**Lack of Risk Based Analysis:** - according to document review of ERCA VAT refunds are not high-tech selective and based on an assessment of risks, if the authority practices this mechanism it can speed up the settlement of VAT refund. Tax officials also reveal lack of basic tools and

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

methods to assess and the absence of organized and sustainable identification between legitimate exporters with a good compliance history for refund claim and other claims.

Due to lack of basic risk analysis most of VAT refund claims are systematically subject to audit otherwise loss of government revenue. According to the interview of taxpayers the complex procedures and excessive delays in processing refund claims made a legitimate taxpayers are considering negligence of the tax authority to eliminate undesirable practice of the VAT system that contribute to the poor effectiveness and efficiency of tax administration.

**Insufficient Budget:**-the interviews with ERCA officials reveal, even if fast economic growth in Ethiopia the refund budget practices shows lesser retention when compared to other competitor countries. The level of VAT refund retention (from total VAT revenue) for instance in Ethiopia now is 15% against 35% in the OECD countries and 27% in Latin America in 2008 (Bodin and Koukpaizan, 2009). This amount is not Match with the level of refund requests of taxpayers for instant, in large tax payers office the retained amount is not enough to pay for the refund claim so the office sometimes take credit from other branch offices otherwise they retain additional amount by its authority.

**Corruption:** - the interview of taxpayers reveals, complicated refund processes and subjective decision that made by the officer which lead to corruption. So most tax payers are not applying refund claim, due to tax officer harassment, rejecting invoice that contain enormous amount and complex audit and unethical practices. They are forcing taxpayers to negotiation on the amount when approved the refund claim. According to interview of taxpayers reveals, the authorities should avoid complex process via strictly follow up proper implementation of tax law.

Farther, in-depth interview with tax officials shows, the level of non-compliance with VAT and fraudulent activities are high so it is not avoided by the present tax system, particularly in Merikato area (the largest market place in Ethiopia) where there is transaction that sales of invoice for any purpose which cause for increased VAT refund and corruption. So to mitigate the problem the interviewer says ERCA should conducts proper investigation audit at each branch office.

Regarding VAT refund problem related to customs, the customs collect VAT when goods are imported through customs clearance. The custom authorities which give approval letter for

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

import VAT (VAT on imported goods) then they made refund claim on the domestic branch offices when they have VAT credit. The practice shows some importers are not issuing the sales invoice and there is information gap between the two branches since they made refund process annually. Therefore fraudulent tax payers have possibility to obtain VAT refund and the procedure open the get for unethical practice

According to interviews of seiner auditor in eastern branch of ERCA reveal that there are no clear rules, accounting methods and directives not only for taxpayers and also tax officers in ERCA. This opened room for subjective decision of tax officers (refund as well as audit process). To mitigate the problem currently ERCA eliminate field audit, paying good salary and overtime payment to support the tax administration. Even if the authority take this action so far no change because ERCA minimize only officer's contacts taxpayers and tax officers, which does not minimizes corruption. So, the tax administration should do on tax officer's attitude change, by recruiting and retaining qualified tax officers.

**The IT System (SIGTAS) does not Properly Support the VAT Refund Process:-**According to in-depth interview of tax officers ERCA has its own information technology server (IT system) in order to protect the tax payers' rights and to ensure the tax evasion effectively. However, management of the system and tax officials has a drawback in using it. The data base of ERCA does not capture the requested, refunded, the rejected and overall refund related information. Apart from this the number of taxpayers captured by MIS is different from the number of taxpayers recognized at each branch office of ERCA.

So, the absence of effective utilization of IT system creates risk on taxpayers and tax authority. On taxpayers it cause delayed VAT refund payment which also lead to cash shortage and for the authority loss of revenue due to manual operation. Even it open the get as opportunity for illegal taxpayers make duplicated refund request with the same invoice due to absent of effective IT system record and/or capture of actual data.

According to the interview of tax officials reveals, the tax authority introduced desk audit in three federal branch offices which may reduce illegal refund request. The other interviewer who employed in head office were criticize current practice of VAT refund, the VAT refund practice based on working manual of ERCA refund process department which obelized summation of supplying company VAT return in order to made refund process. If the suppliers are not declare

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

the stated amount with its reason the other taxpayers refund claim dose not processed until the supplier declare the stated amount, this may needed more attention to improve.

### **Causes for VAT Refund Claims in Ethiopia**

**Economic growth:**-According to the interview of ERCA official reveals that, VAT refund requests largely come from federal government taxpayers. The reason to increase the number of VAT refund requests is due to fast economic growth in the country. Since 2005 GDP were grew at an average 10.8% per annum. This shows there is interlink between economic growth with consumption. VAT is a consumption tax that assumed as main source of tax revenue and that cause increased refund claim from time to time.

According to the document analysis Ethiopia is one of the fastest growing economies in the world. In 2014/15, real GDP grew by 10.2%, keeping the momentum of the 10.3% growth rate of 2013/14 and with the corresponding reduction in poverty levels that following more than a decade of negative growth which increase refund request (Kibret and Mamuye, 2016).

**VAT Withholding:** -According to the interview with tax officials reveals that, the main objective of introducing VAT withholding scheme is to increase VAT revenue collections. However, now day it becomes principal one for VAT refund claim (biggest source of VAT refund claim)in ERCA. According to the review of document, from total refund claims VAT withholding schemes score more than 60% of refund claim in the three federal branch office of ERCA (see table 4.1). For instance in the year 2013/14, 2014/15, 2015/16 and 2016/17 it score 62%, 86%, 66% and 65% respectively. However the introduction of VAT withholding scheme is to collect VAT from agents but its downside is increasing the number of refund claim in ERCA.

**The Level of VAT Incentives:** - According to the interview of tax official reveals that, there are different types of incentives in Ethiopia. Among them zero rating, VAT deferment and VAT exemptions to food staff. Zero rates apply primarily for exports and to some other types of transactions which should not bear VAT for social and economic reasons. The other incentive provided by ERCA is VAT deferment. VAT Deferment is an officially allowed temporary delay of paying VAT on import of specific capital goods and the right to use bonded warehouse to the taxpayer for limited period which is not more than four month (120 days) in Ethiopia.

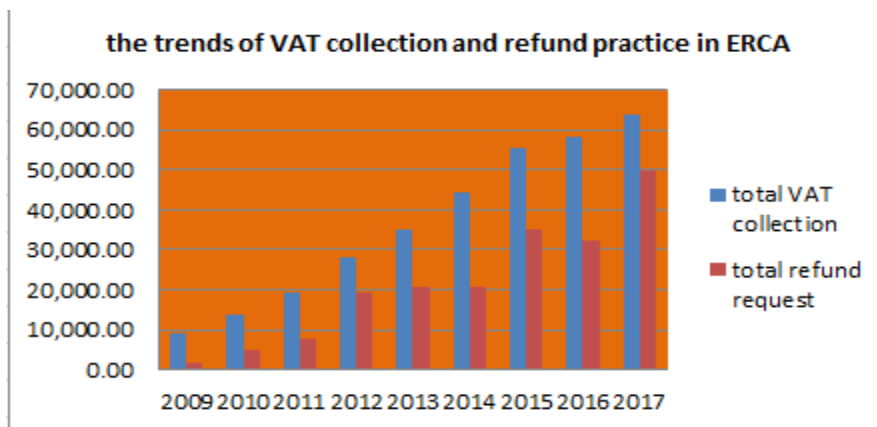
## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

According to the interview of tax officials reveal that, ERCA exempt supplies which are VAT is not chargeable. A trader of exempt supplies is not required to register for VAT even its annual turnover meets the threshold. The VAT paid on the purchase of inputs in the production of exempt supplies is not claimable. If a supplier works in both exempt and taxable supplies, she/he can register for VAT when taxable supplies meet the threshold for registration. This also causes the issue of apportionment, when claiming input VAT credit. The registered business has the right to prorate his input tax credit claim. Exemptions also apply on imports but have no ground for VAT refund claim.

**VAT Refund Fraud:** - the document analysis shows, one reason for growth of VAT refund claim is VAT refund fraud and VAT refund fraud is a global problem. It challenges the tax administration of the revenue and affecting government ability to finance public services. Which reduce government revenue whereas the related risk of detection is also limited in ERCA, the tax officers also says, the largest risk of VAT fraud is from false claims of input tax, the taxpayers claiming the input tax by using illegal tax invoice. However, ERCA sets out the requirements of what exactly must be indicated on the tax invoice for it to be valid.

The interview of refund management revealed that every refund process were manual based. The IT system of ERCA or the authority data base were recorded only the amount of refunded but not the whole history of refund process i.e. the amount requested, rejected, who applied refund claim, when and to what amount information are not properly considered by the system. So it is difficult to identify the refunded amount periodically even there is opportunity to process duplicated refund request as stated earlier.

**Graph 4.1: VAT Collections and Refunds in ERCA**



**Source:** Ethiopian revenue and customs authority (ERCA)

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

According to document review it is important to note that all VAT refunds are paid out of VAT revenue collected in ERCA. This practice tends to; at times, adversely affect the performance of this tax type. The performance of VAT and the associated refunds over the period is shown in the above graph is begins from 2009 up to 2016 in the period 2009 the level of VAT claim is lower than the current year of 2016 this may be increased the level of taxpayers conciseness to exercise its right over period, VAT refund fraud and the tax administration may increase the tax bases.

### 4.2.2. Value Added Tax (VAT) Revenue Performance

According to the document review the performance of VAT can be analyzed from the perspective of VAT productivity. VAT productivity can be calculated as:  $\text{VAT productivity} = (\text{Net VAT collections}/\text{GDP}) * (1/\text{Statutory VAT rate})$  analyzing VAT productivity eliminates the effect of rate changes. Another measure is the C-efficiency which uses the same principle, but uses the value of total Consumption in the economy and not GDP.  $\text{C-efficiency} = (\text{Net VAT collections}/\text{Total Consumption}) * (1/\text{Statutory VAT rate})$ . Since VAT is a tax on consumption, rather than all economic activity, in principle, the C-efficiency can give more accurate measurement of VAT performance

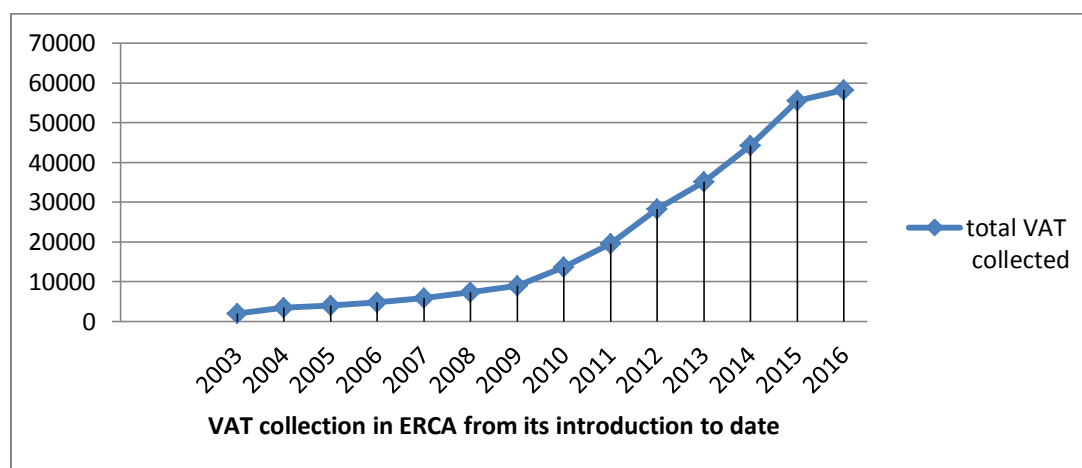
**TRENDS IN VAT COLLECTION (2004-2016):** - Switching from the sales tax to VAT brought strong fiscal effects in first two years of implementation. In order to measure the efficiency of VAT system in Ethiopia by the amount of revenue collected as compared that in the period in which the sales tax was a very successful reform. In 2005 as much as 51% more tax was collected in VAT and cover sales tax than in 2003. The first year of the VAT introduction was also specific for the significant share of lagging sales tax, as a result of the increase in imports of goods and services that were not taxed or taxed at same rate of sales tax (15%) before the introduction of VAT.

According to in-depth interview of tax officials, at the beginning of VAT there are low refund claims due to inadequate awareness and administrative capacity. This low refund claims contributed to a high initial VAT collection. Due to the characteristics of the administration of VAT, the first refunds were paid 2006/7. Practically there were deferrals of VAT refunds to other taxpayers during 2006/7 until emerging of ERCA (merging of the three organs in the year 2007/8). Due to these circumstances the implementation of the decision adopted by ERCA on the allocation to the reserve account for refund pay at amount of 5% of collected VAT the

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

elimination of suspension of VAT refunds to other taxpayers led to a strong increase in VAT refunds. As refund requests exceeded the limit of retention during 2008 the tax authority were increased the amount of retention to 10%. For the recent two years VAT refund request is largely failed in ERCA due to some public enterprises are delimited from applying VAT refund claims such as Ethiopian Electric Power Authority (ELPA) and Ethiopian Real way authority (ERWA) payments resulted in the transfer of a significant portion of refunds the share of VAT refunds in the mentioned period, so the net collection of VAT was higher since the introduction of VAT and the trained was shown on the following graph.

**Graph 4.2 trends of VAT Collections in ERCA**



**Source:** data from annual report of ERCA

In general VAT revenue collection in Ethiopia shows, increasing slowly for the first seven years which scores not more than the first 10,000. However, it increase with alarming rate after 2010, which may be the level of taxpayers awareness towards the VAT increasing and among other reasons and the VAT collection trained shows in year 2003 ETB 1,933.09million, posting ETB3,488.27million in the year 2005 then ETB 4,032.05million in 2006 and ETB 4,808.77million in 2007. However, for the recent years the VAT collection trained shows ETB 44,218.56million in the year 2013, ETB 55,465.62million, ETB 58,132.06million and ETB 63,762.15million in a year 2014, 2015 and 2016 respectively which implies a positive increment of VAT revenue.

The following table also summarized gradually growing VAT collection that contribute in average 40% to total tax revenue, 51% to total indirect tax revenue and has now peaked to more than two-third of total international trade which signifies the need of investigation and reforms in domestic VAT collection regarding its declining performance.

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

Its introduction to date VAT collection from imported goods and services are more than 81% of total customs VAT collected (see table 4.5, Appendix 3). The maximum collection of VAT on imported goods and services reflects the crucial enforcement when goods were imported in informal entry point. According to document review, VAT enforcement and collection needs to be balanced as a result so as not solely depend on import goods. The focus on VAT revenue requires greater attention to proper spending and social protection measures. The following table presents the level of VAT collection in the study area (Eastern, Western and in the Large Taxpayers branch offices of ERCA) and its contribution towards total GDP.

Table: 4.7 Trends of VAT collection, VAT to GDP and C-efficiency in the sample area of ERCA (In million ETB.)

Year	VAT collection in LTO	VAT collection in East	VAT collection in West	ratio of VAT in LTO to GDP	ratio of VAT in Eastern to GDP	ratio of VAT in Eastern to GDP	C-Efficiency	ratio of total VAT to GDP
2010	7,263.66897	953.689	726.1597	1.92%	0.25%	0.19%	0.39%	2.36%
2011	11,140.7445	1,742.649	985.275	2.16%	0.34%	0.19%	0.49%	2.69%
2012	15,105.8789	2,103.502	1,312.197	2.02%	0.28%	0.18%	0.46%	2.48%
2013	19,654.122	2,057.005	1,899.312	2.27%	0.24%	0.22%	0.50%	2.72%
2014	26,689.08	2,689.282	2,387.687	2.54%	0.25%	0.23%	0.56%	2.99%
2015	26,272.566	2,549.917	2,631.852	2.02%	0.20%	0.20%	0.47%	2.42%
2016	28,606.291	3,256.56	2,928.448	1.87%	0.21%	0.19%	0.44%	2.28%

Source: annual performance reports of the three branches of ERCA

We can understand from the table the total collection of VAT is not equal in terms of the contribution of VAT towards total GDP of the economy in each branch of study area at different period of time. For instant the contribution of LTO, Eastern branch office and Western branch office towards total GDP in the year 2010 was 1.92%, 0.25% and 0.19%. Average C-Efficiency was 0.47%. This implies the contribution of Eastern and Western branches towards total GDP is almost less than one percent. However, the contribution of LTO towards total GDP is almost more than 2% in average, in other words LTO contribute almost half of total VAT revenue of ERCA towards total GDP.

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

The following table tried to summarize the performance of VAT by considering the share of VAT to total tax revenue, the share of VAT to GDP and the share of VAT from total indirect taxes.

**Table 4.9 Summary of the trends in VAT collection, as a % total tax, GDP and VAT to indirect tax in ERCA**

FY	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
VAT collection in million ETB	4032.05	4809.15	5931.48	7312.70	8988.18	13677.94	19503.80	28320.21	35169.87	44218.56	55465.62	58132.06	63762.15
VAT to total tax revenue	41%	43%	42%	38%	38%	38%	38%	40%	42%	41%	43%	40%	40%
VAT to GDP	4%	4%	4%	3%	3%	3%	4%	4%	4%	4%	4%	4%	4%
VAT to total indirect tax	51%	53%	52%	47%	50%	52%	53%	54%	56%	57%	59%	56%	56%

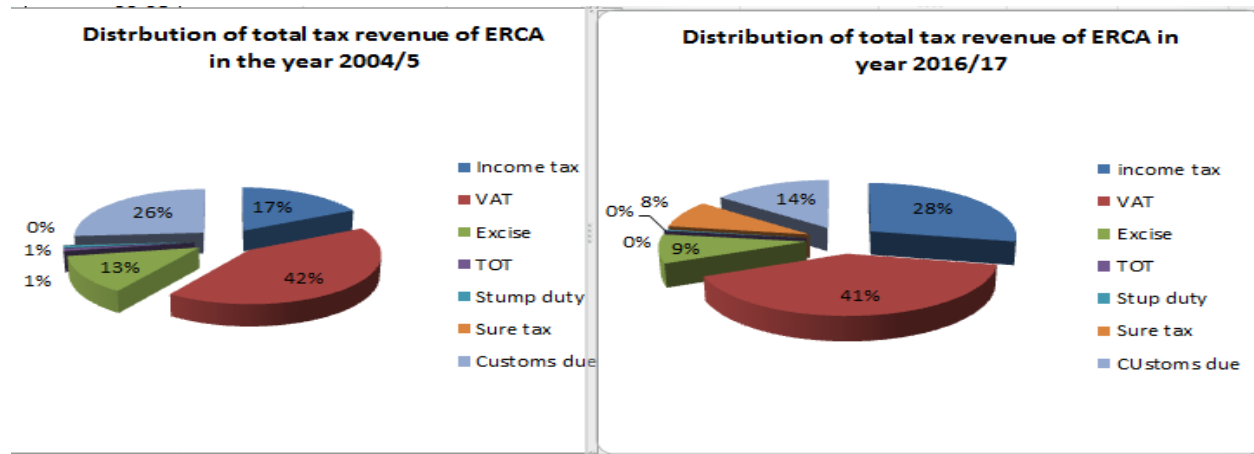
Source: data from annual report of ERCA

The objectives for introducing VAT were to increase total tax revenue collection in addition to replace sales tax. According to document review the VAT revenue data under these table shows since its introduction the VAT has made a substantial contribution to public revenues. The revenue yield of VAT as a share of GDP and the total tax revenue has increased steadily over the years. However, it is relatively flat after 2005. Despite the slow growth of the VAT to GDP ratio VAT remains a major source of tax revenue in Ethiopia as stated above in average it contributed 40% of the total tax revenue since its introduction.

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

Since, the annual report of ERCA stated that, ERCA did not utilize the available resource and resulting low performance in VAT revenue collection. So it is very important to study the VAT Administration practice and Revenue performance in order to understand the gap in VAT administration practice which causes for improved government revenue and guarantee economic stability. The following graph also shows overall tax performance in the past decade.

**Graph-4.3: Distribution of Total Tax Revenue**



**Source:** data from annual report of ERCA

This graph implies types of tax bases which show in the introduction period of VAT and at current period of Government tax administration and the dominance of VAT revenue among seven major taxes in Ethiopia in terms of tax revenue collection. The proportion of VAT to indirect tax, VAT to income tax and overall tax collection at the beginning of VAT and current year collection shows the highest contribution of VAT to total tax revenue.

However, there is fluctuation as stated reputedly over the period and at the beginning of VAT its share to the total revenue is 42% which is better performance than the current year performance of 41% which is consistent but not increased as expected. The reason for its decrease it may be the level of tax incentive, Number of refund claim, the introduction of VAT withholding and VAT refund fraud are expected. Farther, the contribution of excise tax and income tax seem too far away over the years. Despite this role as the interview of tax official says overall tax compliance especially VAT compliance remains at a low level partly because of many informal activities and most of taxpayers are declare VAT without payment (nil).

As mentioned above efficiency in the revenue system of the government can be measured by various means. In case of the consumption taxes for example VAT the most frequently used tool

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

is the C-Efficiency Ratio. It is defined as the ratio of the VAT revenue to consumption divided by the standard VAT rate (Keen, 2013). Furthermore, two strands of thought are apparent in using the consumption expenditure: - overall consumption expenditure and private consumption expenditure; the latter is considered in case public consumption expenditures and all goods/services are free from value added tax. The difference between the two alternatives is that the C-efficiency ratio is normalized by reference to a consumption-type VAT, whereas the Efficiency ratio is normalized by reference to an income-type VAT (OECD, 2012).

In this study we used overall consumption approaches in estimating the C-Efficiency Ratio in Ethiopian tax system. The purpose of using CE is: C-efficiency ratio measures VAT in terms of consumption as stated, however, VAT is a tax on consumption and is calculated by taking the proportion of VAT as a share of total consumption divided by the standard VAT rate i.e. This statistic is a more reliable measure of VAT performance than the VAT productivity ratio as it is based on production (GDP) rather than consumption (Keen, 2013). Under appendix 3 table 4.7 shows the necessary data and calculated results of the VAT performance in Ethiopia which is summarized under the following table.

**Table 4.8 Trends in VAT Productivity and C-efficiency in ERCA**

FYs	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
C-efficiency	4%	11%	11%	10%	11%	10%	11%	14%	17%	18%	20%	22%	24%	20%
VAT productivity	3%	9%	10%	9%	9%	9%	10%	13%	14%	14%	16%	17%	18%	16%

**Source:** annual report of VAT collection in ERCA and own calculation result

From the table VAT performance measure results, average C-efficiency ratio in Ethiopia in the year between 2003 up to 2016 (its introduction to date) is 14% whereas VAT productivity is 12% in average which imply overall trend of VAT is increased from time to time with 15% standard VAT rate which may be comparable with the result of IMF (2018). However, lower when compared to other African countries such as Botswana, Burkina Faso, Ghana and Uganda average VAT efficiency ratio in 2012 were 0.42, 0.37, 0.45 and 0.38 respectively (WBG, 2017).

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

### **4.3. Discussion**

This section presents the discussion and interpretation of the results having the necessary data collected and presented in section 4.2.

As stated earlier VAT refund is one of the key features for economy growth. It is generally accepted fact that the economic growth of the state is connected with the development and extension of tax base. Thus, creating the certainty and flexibility in tax administration, particularly in VAT refund procedures will be beneficially impacted the public (Antic, 2014).

According to the VAT proclamation No. 285/2002 article 28 that specifies the VAT administrations is given to Ethiopian revenue and customs authority (ERCA). In this regard the PLC, share company, joint ventures, public enterprises, subsidiaries and sister companies, those pay profit tax for the federal tax authority and VAT administration undertake by the authority. But the authority delegates his duty to the sub-national/city government tax collecting bodies. VAT administration by sub-national/city government tax collecting bodies focus on the sole proprietors who pay profit tax to them.

ERCA used different mechanism to collect its delegated VAT revenue from city government for instance demarcation of responsibilities between central and sub-national government, impact on VAT management with regard exchange of information across administrative jurisdictions, identification of VAT registrations, filling and payment of returns and refund of VAT including role of customs.

For harmonization all over the country there is permanent meeting two times in a year with sub-national/city government tax collecting bodies. The main focusing area is VAT administration and discussion on performance report among the participants. Based on these, the responsibilities of VAT refund activity as all other VAT administration activities were given to the branches those who render services on the domestic tax.

The branches also retained the VAT revenue and used the amount for the VAT refund based on the directives mentioned in the analysis part. But in Addis Ababa Sub city the VAT refund is made in selected branches (Qirqos and Bole sub city). So the rest of the branches collect VAT and retained the amounts then remit to Arada Sub city Finance and economy office.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

According to African Economic Outlook (2018) major activity in VAT administration are: identifying tax payers, processing returns, controlling collections, making refunds, auditing tax payers and levying penalties. From such administration activities the priority task to identify the tax payer's registration based on the taxpayer annual declaration, third party data collection, estimating committee visiting the taxpayers business and so on.

According to VAT proclamation article 16 tax payers who have an annual turnover of 1million ETB and above are obliged to be registered as VAT taxpayers. In addition to this, the directive No. 25/2005 of federal Inland Revenue authority (FIRA) identify 9 selected sectors expected to exceed the threshold those engaged in such selected sectors such as gold smiths, plastic products manufacturers and computer and accessories suppliers to register for VAT regardless of the level of their annual turnover.

Also the result of interview shows, from the beginning of VAT registration VAT administration practice complicated and difficult in Ethiopia due to lack of awareness in both taxpayers and tax officers. The taxpayers are not willing to register for VAT on time due to fear of the tax authority decision and sometimes tax authority made VAT registration deliberately when annual turnover met to the threshold and required back payment of VAT including interest for let pay. This registration is made without the awareness of taxpayers and cause for nagging between both parts.

However, the result of the study revealed taxpayers are applied self-assessment principle in Ethiopia which is most of developing country are practiced. According to Bodin and Koukpaizan (2009) Experience of most African countries where self-assessment has been introduced in the past 20 years. In ERCA to enforce for VAT registration the tax authority used the means of attachment with clearance that the taxpayer needs it for different services. Concerning small firms, whose annual turnover is below the threshold for registration, have the option of voluntary VAT registration with criteria.

The analysis of the VAT refund procedures, challenges, cause for VAT refund and revenue performance in Ethiopia and experience in other countries will be presented in the subsequent paragraphs. The analysis also shows the requirement of fundamental reforms to obtain VAT refund timely and collection of VAT in ERCA. The VAT refund practice in ERCA aim to provide suitable service to taxpayers and increase tax revenue for the government.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

In Ethiopia VAT is imposed on the import, manufacturing, wholesale and retail levels on both goods and services at a uniform rate of 15%. To determine the VAT liability tax paid on inputs is creditable against output tax and the VAT returns are required to be declared on monthly base. So only registered traders are allowed to charge VAT on the supplies of taxable goods and services as stated earlier. But VAT for exports (i.e. applying at zero rate), allowing the exporting firm to claim VAT paid on inputs. This practice makes exporters competitive on international market.

However, the results of the study revealed that VAT refund program remains undeveloped in ERCA only emphasis on tax assessment and audit but VAT refund assumed as cash out flow. The trained of VAT refund under table 4.1 shows there are a number of VAT refund claims in the three Federal branch office of ERCA. The largest amount of VAT refund claim emanates from VAT withholding claim types and the largest VAT revenue collection and VAT refund claims were comes from LTO at the same time vast tax incentive are used by those taxpayers. VAT withholding claim score in average about 60 percent of total VAT refund claims.

Farther, the result of the study revealed ERCA conduct an audit except for large amount of refund claim and VAT withholding types of refund claims. However, Experience in Tanzania shows all VAT refund request verification activities are undertaken by the tax authorities. Also the VAT laws in Tanzania allow, every refund claim must be verified by an auditor registered by the Tanzanian national board of accountants and auditors (Harrison and Krelove, 2005). However, after tax reform in tax refunds repayment claims, a country classified all claims into three categories namely, gold, silver and non-gold silver.

Another experience, as Harrison and Krelove (2005) also noted in Kenya VAT refund claims exceeding a specified amount must be certified by a CPA registered with the Institute of Certified Public Accountants of Kenya. The law imposes sanctions on accountants who knowingly certify false claims. According to document analysis tax authorities, traders and accounting professionals all contend that this approach has benefits. Tax officials argue that it helps eliminate fraudulent claims and reduces administrative costs. According to Harrison and Krelove (2005) a result of tax reform in Kenya the number of refund claims by exporters

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

dropped by 40 percent following introduction of the scheme, suggesting that many firms had been submitting false claims.

Farther, as Omokahuale and Immanuela (2016) noted, Nigeria improving tax related services by tax authority particularly on VAT refund request verification activities, were based on computer system in order to improve trade facilitation and tax management to their business in the economy (NRA, 2014). However Ethiopia did not use organized IT system for VAT refund which takes long time to process VAT refund and the time period is questionable in ERCA. Since the directive of VAT allow tax payers to obtain refund before the audit have been conducted Except for VAT withholding claims and large figure refund request.

Practically tax authority follows the same procedure for all other refund claims, simply checking the occurrence of transaction between taxpayers and the suppliers whose declaration of VAT return (declared or not), the procedure may require further improvement in order to make stable VAT administration unless cause loss of government revenue. As Carter (2006) noted, properly managed and timely VAT refund is essential to ensure the tax is an efficient and poor tax on consumption and any delay in VAT refunds would add a layer of hidden costs to registered firms and thus discourage investment.

In our case the VAT law enforced to carry-forward period for import and domestic supplies of goods and services for excess VAT credit, which is five reporting periods (5 months) then they refunded it within 2 months up on taxpayers refund request. Whereas for selected sectors such as Authorized Economic operators (AEO) the excess credit is refunded within 7 days.

Regarding the refund claim for NGOs and diplomats ERCA allowed practicing VAT refund procedure with target to control and limit misuse of resources in performing their activity as they proposed. While, both are not liable to VAT registration (VAT exempted) but they will obtain the refund payment within 30 days. ERCA used this refund procedure as a mechanism to examine their purchase invoice which should be approved by delegated management of those organizations. No matter how the law allowed fast-track refund processes for selected business sectors as we can understand from the result of the study there is still many limitations including shortage of budgeted cash, increasing No. of refund claims with limited tax officers are among other limitations and which needs further reform.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

Regarding the time to VAT refund payment experience in other country shows, there are different systems used in Sub-Saharan Africa, including the use of VAT credits against future tax payments (Ghana, Kenya, Madagascar, Malawi, Mali, and Senegal). VAT refund on quarterly bases (Cameroon, Chad, Equatorial Guinea) and refunds following audit verification (Mozambique and Namibia). Audit verification can help to reduce refund fraud; administrative delays can result in a buildup of unpaid claims adversely impacting the private sectors, as it has been practiced in Zimbabwe and Zambia (REO, 2018).

However, implementation of an audit program is still a major challenge in Ethiopia. As the document review in ERCA shows there is no separate audit for VAT refund except as mentioned above subjectively decided the level of refund claim and VAT withholding claims are audited. For other types of refund claims the tax officers are simply checking the required documents of taxpayers and sales invoice of supplying business. Tax payers have complained on the guideline because the practice may affect the business organization that have refund claim and the tax authority. According to Kadenge, (2012) lack of adequate administrative capacity in many African countries, tax policy and tax administration aspects are more closely linked than usual.

Regarding methods of VAT refund budgeting as Charlet and Buydens (2009) note, there are two methods of budgeting for VAT refunds (1) making payments from gross VAT revenue or (2) paying from budget expenditure appropriations, the choice of which method to use is influenced by historical and legislative (constitutional) factors. The Practice in ERCA shows, VAT refund payments made from gross VAT revenue. Which is now 15% of collected VAT revenue are used for VAT refund in each branch, where VAT is collected. As stated in the analysis part the VAT revenue amount retained in ERCA was lower than the comparator country in Africa as well as in the world.

Harrison and Krelove, (2005) note, fast growing economy with significant value addition is likely to be refunding more VAT than an economy experiencing stagnant or negative growth. But in Ethiopia VAT incentives, VAT fraud, the introduction of the VAT withholding scheme and economic growth of a country were a key reason for increasing VAT refund claims. As Cottarelli (2011) noted, experience in Zambia a robust refund mechanism was introduced in 2005, and financing of refunds has been ring-fenced, based on returns submitted by the end of

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

one month, and is made from gross VAT (domestic and import) collections in the following month, before the net balance is transferred to the Treasury.

According to the document analysis in Ethiopia, most of VAT refund process is manual based. So the tax administration required to crosschecks all purchases and sales invoices to valid VAT credit claims (as well as identify undisclosed sales) through manual cross-checking cause for suspicion in VAT refund and loss of revenue.

Experience in Korea, as Gijsbert Bulk (2017) noted the first commencing an ambitious invoices cross-checking program was in Korea in the late 1970s. More recent attempts have been made by Indonesia, Bulgaria, Azerbaijan, and Albania. A feature of the systems developed by these countries is that they require taxpayers to submit copies or a list of invoices with their regular VAT returns details of which are then entered into a central database.

The study result reveals, ERCA did not perform the VAT refund as expected due to the problem of both tax administration and taxpayers. The problem of taxpayers: they are not fulfilled the required documents to process the refund and taxpayers also not return back to the tax center when they asked for the unfulfilled documents and they bring illegal invoice to obtain unnecessary benefit. On the tax authority side: lack of positive attitude, skilled and experienced officers to execute the refund process based on the standard stipulated in the VAT law. the tax officials also refuse to perform their responsibility and slow initiation to use IT.

There are more than eight types of VAT refund claims in ERCA which is large in number and allocated different time to refund pay. This practice resulting confusion for taxpayers and tax officer (see table 4.1). Experience in Tanzania shows as Harrison and Krelove (2005) Noted Tanzania categorized VAT refund claim into three: the gold category which covers regular payment traders who meet the qualifying criteria and their claims are settled within 30 days from the date of lodgment. The Silver category is for regular payment traders not meeting the gold criterion. Claims are settled within 30 days from the date of lodgment for two consecutive claims but full-scale audit is prerequisite for the third claim settlement. The non-gold silver category is for the claimants who require thorough audit before affecting their refund claims.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

Further, Ethiopia performed a wide range of organizational, institutional and various tax reforms and amendments to create fair, flexible and modern tax system that results utmost tax revenue at minimum cost for both taxpayers and tax administration system. However, the interview result shows, the tax officers process the VAT refund according to the directive of VAT refund but the taxpayers say, the tax authority did not performed as the directive and make it complicated even they have no initiation to serve tax payers as expected and they required unnecessary documents to check and to consider the VAT refund. In addition, tax officers are rejected legal invoice with minor reason and the amount of refund as verified.

The practices of most developed countries, VAT refund are generally paid within four weeks of a refund claim after being made. The situation is different in ERCA, where sometimes it takes several months and sometimes more than a year, to process refund claims. According to WBG (2015) study, In Ethiopia about 43 percent of the study population of federal branch office of ERCA respondents shows, eligible taxpayers are did not apply for VAT refund in the 2014 tax year. for this Several reasons were mentioned in the study. Major ones included: small refund amount, they belief not get the refund and complicated formalities for refund.

The interview result also shows, to mitigate the problem ERCA planned to modernize the tax administration by introducing investigation audit by avoiding felid audit, allocating the resources mainly on VAT refunds and also introduced desk audit in refund department in the three federal branch offices of ERCA to pay attention beside other risks of VAT fraud and evasion.

Regarding VAT refund fraud, the interview result shows, there is encouraging progress in tax administration however, the VAT fraud is large in ERCA due to absence of effective IT, risk based audit procedures and other mechanism to verify legal invoice which need more effort. Farther, interview result shows the growing refund claim emanate from refund fraud, as stated in the document review section, VAT refund fraud is a global problem and miserable tax administration results significant revenue loss and affecting governments' ability to finance public services.

As stated in literature section fraudsters have targeted VAT refund schemes and in some cases, have used the proceeds of their crime not only to steal revenue but also to finance other criminal activities. The interview result shows in Ethiopia both of the VAT fraud and evasion can takes

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

place particularly in Merkato area where large taxpayers are made illegally transaction and as stated reputedly the large refund claim emanate from large taxpayers office (LTO).

However, ERCA tray to mitigate the problems stated above but which is not enough yet there is transaction that conducted without issuing invoice mainly by large taxpayer's (importers). Since wholesalers are distribute their goods for retailers without issuing invoice or issuing for portions at store but the retailers are frequently inspected by the tax officers. Therefore legislative provisions and substantial improvements in the processing of VAT refunds require development of more effective audit programs based on risk management.

Farther experience in other country shows the largest risks of VAT fraud are false claims of input tax, countries require that the vendor claiming the valid tax invoices. Ethiopia sets out the requirements of what exactly must be indicated on the tax invoice for it to be valid. Similarly other country experience shows in Ghana, before a VAT claim made, the vendor must have a valid customer entry, an assessment notice and the tax invoices for the services received. In Kenya also Revenue Authority is asking for proper documentation to be submitted by the VAT vendors before refunds claim will be paid. One of these documents is an auditor's certificate where the claim exceeds Ksh 1 million. This is a good tool to ensure that the large false claims are not made.

According to Feria and Schoeman, (2016) VAT fraud and evasion can made by Under-Reported Sales and Failure to Register which is broadly characterized as black market fraud or shadow economy fraud. In order to combat fraud, as AEO (2017) noted, Benin's revenue agency deployed more staff to the units dealing with fraud and implemented strong controls, such as improving the equipment and number of staff that collects the revenue. On the same report, the Republic of Congo introduced a unique identification number whereby each registered taxpayer is given this unique number, improving the tracking and administration for the revenue authority.

According to paying tax (WBG, 2017) reported, Cameroon's tax authority has a systems where information is shared between inter related countries and the customs services. This reduces fraud on cross-border activities. On the same report South Africa has information-sharing agreements in place which improve the recovery of money which is not visible in the financial system. According to this report VAT audits are an effective tool to pick up VAT fraud. In South

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

Africa, the VAT audits show that up to 60% of reporting is inaccuracy. The construction industry is of great concern where 70% of the audited VAT cases indicate wrong disclosures.

However, ERCA may not achieve the expected VAT administration and better revenue performance in the absence of IT system along with the manual operation. Without effective IT system it is difficult to control VAT refund fraud and evasion. Since, IT system in ERCA considers only when the data captured on SIGTAS as the payment. The IT department of the authority i.e. data base were recorded only the amount of refunded but not the detail of refund information what amount is requested and rejected.

Related to this the in-depth interview result showed it is difficult to identify the refund paid taxpayer periodically even there is an opportunity to process duplicated refund request. so, the tax authority try to give a response for business community to improve services and modern tax administrations through fast track refund processing for selected exporters known as AEO by focusing on their contribution of foreign currency and good compliance history for refund process in order to create fair competitiveness.

The result of document review in ERCA shows the government of Ethiopia provides opportunity to manufacturing industry and exporters to obtain different incentive in order to promote investment and free trade computation which may reduce revenue collection.

However, experience in Nigeria as Harrison and Krelove (2005) noted incentives are given for manufacturing industry that engaged in production of exporting products. These sectors obtain huge incentives among the others include: the rights to use bonded warehouse system, this system provide for any manufacturing sector that imports input from abroad to produce exporting goods were obtain tax free import service by providing guaranty from legally recognized commercial bank or insurance company of Nigeria. However, the guaranty bond on imported raw materials was refunded after checking imported raw materials were properly used for intended purpose and the products should be exported within that fiscal year (12 month).

Table 4.4 present the proportion of VAT to total tax revenue that remained almost constant in the past years but the growth in total government revenue increased since the introduction of VAT. This signifies better results to the government revenue in the year 2003-2005. However, its contribution become constant and flat in the year 2009 up to 2011 than increasing with

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

reasonable amount up to 2016. As Antic (2014) noted, VAT is increasingly being used throughout the world, including many African countries to raise government revenue with less administration and economic costs than other broadly based taxes. It is believed to be a good means to raise government revenue even when relatively poorly administered. For instance, most taxable transactions will appear on two tax returns (that is the buyer's and the seller's) so that tax authorities will have two opportunities to detect evasion. Further, because sellers provide the tax administration a record of their purchases by claiming input credits, tax administrations are more able to estimate what sales and therefore VAT due should be and thereby can detect evasion more easily in a VAT than in a retail sales tax.

Ebrill and Keen (2011) also strengthen the above idea empirically. They found that in the countries have adopted VAT, revenue from this source accounted on average 27 percent of the total tax revenue or 5% of the GDP. And above 70% of the world's populations now live in countries with a VAT. This implies that it is a key source of government revenue in more than 165 nations.

Regarding VAT efficiency and productivity the result of document analysis shows, Ethiopia mobilized tax revenue at 11.9 percent to GDP in 2002 following major tax reforms (annual rep. ERCA). However, between 2005 and 2009 tax revenues declined by an amount equals to 3 percent of GDP, with large decline in revenue from income taxes and import tariffs.

Farther, Ethiopia experienced sustained strong real GDP growth over 10 percent on average between 2004 and 2011 which come from large part of public investment. Public capital expenditures averaged 10.3 percent of GDP in 2010-2012 and the government of Ethiopia planed the GTP II objective of over 17 percent tax-to-GDP ratio by 2019/20. However, Ethiopia's economy is largely based on agriculture – 46 percent of GDP and 85 percent of employment – which reduces VAT revenue, since it is consumption tax and Agricultural products are tax exempted and huge public investments.

As Zerihun (2016) noted, the economy has been growing at a remarkable rate at an average more than 10 percent, the slow growth in the tax to GDP ratio suggests the growth in tax collection is not proportionate with the economic growth perhaps indicating a huge untaxed potential. Farther, the study result also shows VAT revenue productivity in Ethiopia scores 12% with 14% C-Efficiency in average which significantly lower than that of comparator countries in the region

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

and the world. For instant according to the document analysis, the average worldwide VAT efficiency ratio is 34% and Botswana, Burkina Faso, Ghana and Uganda average VAT efficiency ratio in 2012 were 0.42, 0.37, 0.45 and 0.38 respectively (WBG, 2017). While in Ethiopian the average VAT efficiency ratio is 0.14 and the average c-efficiency ratios in South Africa between 2007 and 2013 also 63.6 percent, which is relatively high; the high c-efficiency ratio in South Africa's is partly a result of limited number of exempted and zero-rated goods and services (IMF, 2015).

The result of efficiency measure suggests that VAT is not performed as expected in terms of VAT revenue collection. For this there are two reasons: first the exempted products/services are large proportion of the goods/services consumed by average citizen by considering the level of poverty in the country. The second reason is problems with taxpayer in which the tax payers are not properly compliance with tax return and tax authority is not enforcing the law at concerned part. In general, higher c-efficiency ratios indicate better performance of the VAT.

From the study result we can understand our tax system generate lower c-efficiency ratios when compared to that in other low-income countries which needs modification of tax system in order to produce sufficient amount of revenue to finance government budget and to sustain the economic growth. As Badalyan (2008) noted, Taxpayers should pay the exact amount of tax that they are required for particular transaction and no less or more.

Finally, this study was simply focused on describing VAT refund practice and revenue performance in Ethiopia and the quality of the calculated ratios of the efficiency of the VAT system in Ethiopia depends on the quality of VAT revenue data and consumption data in the country. For this reason certain adjustments of the potential taxable basis for VAT, level of corruption, the level of transparency in the tax administration cannot be included and/or determined in accordance with the OECD methodology (2012) and Keen (2013).

# **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

## **CHAPTER 5- CONCLUSIONS AND RECOMMENDATIONS**

The previous chapter presented the results and discussion of the study. This chapter provides the conclusion and recommendations in line with the findings of the study. The chapter is structured in two sections. The first section deals with conclusions whereas the second section presents some recommendations suggested as a solution to problems that have been identified in the study.

### **5.1. Conclusion**

Taxation is main source of revenue for the government of Ethiopia in addition to external loan grants and assistances. It is used for fair distribution of economic resources for the people by the government. A well-structured VAT administration program is vital to achieve revenue objectives that ensure the fiscal stability of the country and sustain the guaranty of the tax system by providing effective service to taxpayers along with voluntary compliance improvement and additional tax collection.

This study was conducted to investigate the VAT refund practice (to identify the related problems of VAT refund, causes to VAT refund, trends of VAT refund) and revenue performance in Ethiopian tax system (mainly focusing on the three federal branch office of ERCA(i.e.; Eastern branch, West and Large Taxpayers Office of ERCA). The study applied both quantitative and qualitative approaches. Specifically, the techniques used in the study include: in-depth interviews with tax officials and taxpayers and document review. The findings from the results are briefly concluded in the subsequent paragraphs:

A legal framework of VAT in Ethiopia shows, it is levied on consumption of taxable goods and services supplied or imported into Ethiopia. It is collected by registered persons at designated points who then remit it to the tax authority. Registered persons only act as VAT agents in collecting and paying the tax since the tax is borne by the final consumer of goods and services. Both Export (zero rated) business and non-exporting business sectors are treated at different time limit to process VAT refund claims and to offset future tax credit (the process is complicated to handle and need improvement). The VAT refund process starting from the moment the refund was requested. The net VAT balance is refunded to the business organization only when this period ends. However, the study result shows the tax authority is committed to paying refunds

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

within specified period based on the VAT law and VAT refund directives, but this period is extended most of the times.

The researcher conclude as par the study results, like other developing countries, in Ethiopia the VAT refund claims takes several months and sometimes more than a year. The reason in line with the findings of the study is the IT system (SIGTAS) does not properly support the VAT refund process (VAT refund process are mainly performed manually), lack of risk based document verification, complex procedures for VAT refund are among others. So, based on these finding the researcher conclude that VAT refund program remains at its infant stage and the refund may assumed as cash out flow.

The analysis also shows the requirement of fundamental reforms to pay VAT refund timely and to collect VAT revenue in ERCA. Since, the VAT refund practice aimed to provide suitable service to taxpayers and increase tax revenue for the government.

The result of document review shows, VAT refund increased from time to time the reasons for increasing are, the introduction of VAT withholding schemes, since more than 50% of the VAT refunds emanates from the VAT withholding schemes. VAT incentives (export, agriculture; manufacturing and mining had vast incentives in the form of zero rated goods), the economic growth and VAT refund frauds are the main reasons for VAT refund increasing in ERCA.

The result of in-depth interview also revealed that there are VAT refund related challenges that tax administration and taxpayers are facing. A key problem in VAT refund practice that hinder the tax payers and the tax authority are taxpayers are not fulfilled the required documents to process the refund and carry illegal invoice to obtain unnecessary benefit. On the tax authority limited methods to process VAT refund, lack of committed personnel, skilled and experienced officers to execute the refund process based on the standard stipulated in the VAT law are among others.

Also the interview result shows in Ethiopia the VAT fraud and evasion can takes place in the business environment, particularly in Merkato area where some large taxpayers are conducts illegal transaction (i.e. they are not issuing sales invoice or issuing for part of transaction) but the retailers are frequently inspected by the tax officers and as stated earlier.

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

Regarding VAT productivity, document review result shows, the average C-efficiency in Ethiopia over the period reviewed is 0.14, or 14% which is lower when compared to Sub Saharan Average and emerging countries economy and compared with others economy, it needs farther improvement in VAT administration.

From the result of the study the performance of VAT revenue and tax revenue are also relatively poor that accounts an average of 4 percent and 9 percent of total GDP respectively during the study period (which is 2003- 2016), this may because of excessive exemption and lack of voluntary compliance, VAT fraud, lack of taxpayer awareness and the weakness in the tax administration itself in particular.

Moreover; in the sample area of the study the total C-Efficiency in average scores 0.47% and the contribution of VAT revenue towards total GDP of the three branches of ERCA are accounts on average 2.11% in LTO, 0.25% in Eastern branch and 0.20% in Western branch office of ERCA during the study period. Though, the results to date suggest that the Ethiopian VAT is not realizing its full potential.

To conclude the absences of detailed information limit us to study the case up to this stage only. Despite these data limitations our in-depth interview and documentary investigation supports to understand the reality on the ground, procedures followed for VAT refund practice, slow refund process, poor tax governance and weak administrative system and organizational capacities to detect VAT fraud and increase revenue performance.

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## 5.2. Recommendation

This section provides some recommendations that mitigate the operational problems of VAT refund practice and revenue performance. So that to improve VAT administration practice and to meet the revenue needs of the government of Ethiopia, The researcher tried to provide briefly the following recommendations:

- ✓ The researcher suggests that ERCA should sufficiently invest and utilized the IT system and used a risk based approach to check the accuracy of refund claims and verify existence of excess input VAT in the taxpayers accounting like practiced in Korea. Since, most of VAT refund process is manual based. Which required the tax administration to crosschecks all purchases and sales invoices to valid VAT credit claims (as well as identify undisclosed sales), as a result delay occurred in processing VAT refund and this imposing burden on not only taxpayers but also on the tax administration.
- ✓ According to in-depth interview and document review results, there are a number of VAT refund claims with limited tax force and budget, for each refund claim different period of time were assigned to settle a claims (which is complicated to handle all at different). The researcher advices ERCA should apply some specific mechanism as Tanzania, a country classified all claims into three categories namely; gold, silver and non-gold silver based on good risk-profile for preferential treatment.
- ✓ Farther, the researcher inform, ERCA should give emphases and ensure practicability of VAT law on large taxpayers. These businesses are mostly engaged in export and import business sectors and associated with operation of VAT withholding scheme (they are large taxpayers); whose refund requests are allowed to be processed within a short period of time it may cause for suspicion in VAT refund and loss of revenue.
- ✓ The result of the study shows there is a gap in identifying honest and fraudulent taxpayers in ERCA which caused for increasing fraudulent taxpayers. The researcher advice ERCA should screen taxpayers in process of VAT registration of new companies needs to be better screened, in order to prevent fraudulent companies from entering the VAT system. E.g. by checking the real identity of owners and managers more and by creating and using a tax history of companies and their owners and managers. It is crucial to checks and controls at this stage of the process for identifying potential fraudsters. If these challenges are addressed

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

it is possible to tap fraudulent companies and increased tax revenue collection efficiency particularly VAT performance in Ethiopia.

- ✓ From the study result we can understand our tax system generate lower C-efficiency ratios when compared to those, in other low-income countries ERCA should be needs to modification of tax system in order to produce sufficient amount of revenue to finance government budget and to sustain the economic growth.

**Finally**, this approach may be useful in addressing the design and practice of VAT refund and revenue performance in regional and sub city. Identifying the trend of VAT refund and revenue performance regional state remains a topic worthy of future researcher.

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# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## *Appendix 1– Tax administrators in-depth interview instrument*

1. *Could you tell me your position of respondents?*
2. *How long you are employed in ERCA?*
3. *Is VAT refund present in Ethiopia? If yes, what is the primary purpose of conducting VAT refund?*
4. *Could you tell me legal framework (i.e. how and what)procedures followed for the Application of VAT Refunds?  
Supplementary questions: by whom it is processed? How document verification was take place? How the VAT refund payment made? How the decision to refund payment certain? What inference or criteria considered for such decision?*
5. *To whom the right to VAT refund claim is given either any limit for refund request application?*
6. *Are VAT refunds paid from consolidated revenue or is there a special budget appropriation? If it is, what happens if insufficient funds have been appropriated to meet all legitimate refund claims?*
7. *Could you tell me the level of taxpayer’s tax awareness to apply refund claim and compliance behavior for Ethiopian tax system? If they are not aware, what ERCA plans to do regarding awareness creation and compliance improvement?*
8. *Are excess VAT credits offset against other tax liabilities (e g, income tax)?*
9. *Could you tell me any stock or aged of unpaid VAT refunds?  
Supplementary questions: How many day/time Taken for VAT Refund Process and pay?  
Is interest paid to taxpayers on delayed refunds?*
10. *Dose the deadlines for submitting claims are managed by the tax administration were in a flexible way? Supplementary questions: Is there any documented procedure for processing VAT refund available?*
11. *Which category of taxpayers and sectors are usually selected for special arrangements for managing VAT refund?  
Supplementary questions: Selection is made by whom? What would be the reason behind this selection? How VAT refund period are selected for each types of refund claim? What are the bases considered for selecting the VAT refund period? How the highest risk taxpayers could be identified?*

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

*What are expecting sectors big refunds emanating from?*

*12. How long an individual VAT refund claim stays on average in ERCA? Is there any VAT refunds claims are usually rejected? Why?*

*13. What is the Impact of Refund Procedures on Business and tax center Decisions?*

*14. Is there any particularly easy refund procedures are available?*

*Supplementary questions: Is there any Electronic submission procedures are available?*

*15. What are Key factors determined by businesses and tax officials to assess the ease or difficulty of VAT refund procedure?*

*16. Is there any business not applying for the VAT refund? Reasons for not applying for the VAT refund?*

*17. What are the main reasons for VAT refund?*

*18. What are Key factors determined businesses and tax officials to handle VAT refund fraud? In which sector most illegal practice takes place?*

*19. Is there any continuous assessment on competency of refund staff? If yes, who performs the assessment? When and how these assessments are conducted? What about the continuous knowledge upgrading processes of staff resources?*

*20. Do you believe that ERCA has currently collecting the potential amount of VAT revenue? If yes, how is it achieved? If not, could you tell me the reason behind?*

*Supplementary questions: Is there any suggestions and comment on overall VAT administration practice and revenue performance of ERCA?*

## **Value Added Tax Refund Practices and Revenue Performance in Ethiopia**

### ***Appendix 2 –Refund claimed Taxpayer’s in-depth interview instrument***

1. *Could you tell me what type of business do you carry out?*

*Supplementary question: categories of your business you engaged? What is your position of responsblits in the business? How long you carry out the current business?*

2. *Have you been applied for VAT refund in consecutive business operation periods? If so, how do you think the served behind this?*

3. *Are you aware of about the tax rules and regulations of Ethiopia? Have you been informed by tax administrators about the new rules and regulations in the Ethiopian tax system?*

4. *Do you get clear instructions, understandable forms, assistance and information as necessary from ERCA?*

5. *How do you evaluate the capability and experience of tax administrators, the practicality of VAT law and refund directives, refund staff and investigators in performing VAT refund practice, and their willingness and capability to help taxpayers through advising and other services? Do you get advice and others services regarding the procedures of tax payment, book and record keeping, filing of tax returns and registration procedures and requirements?*

6. *Is any brocracy in VAT refund repayments with long delays Communication with tax authorities is difficult? And procedures and claim forms are specific to each taxpayer?*

7. *Tax payers overwhelmingly perceive VAT refund procedures to be generally difficult?*

8. *Do you believe that illegal traders come to with false refund claim and use illegal invoice?  
Supplementary question 1: how could ERCA overcome those illegal traders?*

9. *Do you think that ERCA has the capability to pay refund in that stipulated time period in the VAT law?*

*Supplementary question 1: ether any problem you think in the process of VAT refund application?*

*Supplementary question 2: what are challenges taxpayers facing in the application of VAT refund?*

10. *Could you tell me unethical practice of tax officials those motivated to operate in illegal way?*

11. *Could you tell me any business not applying for the VAT refund? Reasons for not applying for the VAT refund?*

# Value Added Tax Refund Practices and Revenue Performance in Ethiopia

## Appendix 3 Tables

**Table 4.1: The trend of VAT refund in the three Federal branch office of ERCA**

types of VAT refund		2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17		
1. fast track (AEO)	total refund requested	No	37	29	24	35	38	35	38	
		in ETB	25,228,914	23,177,394.68	23,032,402	35,253,834.21	26861970.8	31381202.05	24,843,430.15	
	total refunded	No	35	27.00	24	35	37	35	34	
		in ETB	23,904,599.00	21,783,453.08	22,211,955	29,376,216.72	26437893.7	15264407.33	16,182,116.79	
	Rejected	No	2		1		27			
		in ETB	360,570	489,522.21	820,446	187,391.19	239238.26	54452.76	1,887,832.46	
	offset for existing tax	No		1						
		in ETB		3,143,561.66						
	transferred for the next year	No	1	2.00			1	1	4	
		in ETB	963,745.68	904,419.39		5,096,226.90	184838.87	15,783,020.46	6,773,480.90	
	2. Export	total refund requested	No	96	123	64	140	215	114	120
			in ETB	68,482,379.93	123,080,388.60	121,964,864.12	228,900,952.19	392802524	257095934.2	797,052,091.10
total refunded		No		86	41	109	162	84	91	
		in ETB	26,535,823.70	61,915,360.05	68,820,839.67	125,705,675	209030375	151169739.2	412,606,138.40	
Rejected		No	23	3	9	14	129	9	5	
		in ETB	11,854,646.83	33,786,244.58	18,010,692.81	50,564,256.87	70358283.9	73646000.76	340652300.6	
offset for existing tax		No	1	1	1	2	4	3	5	
		in ETB	102156.9	3,151,561.66	11,452,802.41	6,324,944.39	9810694.79	4461347.06	5,489,803.03	
transferred for the next year		No	16	19	23	24	33	23	24	
		in ETB	31653578.5	31,191,769.93	35,963,640.37	46,306,077.60	103603169	31,500,499.44	38,303,849.12	
> . . . . .		total refund	No	1099	1291	1188	782	339	273	1055

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

	requested	<b>in ETB</b>	199,140,588	322,379,778.00	3,537,178,182	629,851,233.98	1444018.82	610977634.2	657,515,963.30
	<b>total refunded</b>	<b>No</b>	1061	356	1119	1260	339	272	1000
		<b>in ETB</b>	195,487,583.90	218,721,558.00	224,038,264	433,538,971.79	117551924	239487234.9	514,326,542.00
	<b>Rejected</b>	<b>No</b>	24		310	271		17	153
		<b>in ETB</b>	57,192,762	74,603,933.00	25,599,546	43,995,043.66	26849887.4	309707228.3	47,720,689.89
	<b>covered by existing tax</b>	<b>No</b>							
		<b>in ETB</b>							
	<b>transferred for the next year</b>	<b>No</b>	17	6	58	130		1	18
		<b>in ETB</b>	11,152,671.15	2,402,009.00	83511572.25	152,317,218.52		61,783,171.01	95,468,731.72
	4. VAT withholding	total refund requested	<b>No</b>	179	187	299	545	526	694
<b>in ETB</b>			493,861,341.30	706,201,480.80	1,591,946,706.00	3,289,867,053.00	6397741244	7020298679	8,953,630,209.00
<b>total refunded</b>		<b>No</b>	104	113	181	396	405	460	475
		<b>in ETB</b>	197,819,381.60	283,768,101.50	641,432,211.40	1,749,690,603	3821494178	41148775095	4,690,834,041.00
Rejected		<b>No</b>	42	4	42	55	243	33	47
		<b>in ETB</b>	72,803,477.32	212,435,787.70	496,131,269.80	717,402,928.50	383485035	857500375.9	952778685
covered by existing tax		<b>No</b>	11	18	17	10	19	40	27
		<b>in ETB</b>	35,729,768.06	80,124,730.21	175,054,392.90	98,631,855.45	61437573.8	172033349.8	159,722,059.20
transferred for the next year		<b>No</b>	33	18	83	117	64	194	173
		<b>in ETB</b>	184,006,326.40	148726446.3	275,555,303.00	724,698,690.30	639452285	2,471,989,659.00	3,082,988,617.00
5. regular VAT refund	total refund requested	<b>No</b>	77	56	53	63	51	516	180
		<b>in ETB</b>	667,810,396	1,258,383,630.00	784,092,164	659,458,089.46	303031225	1949132877	2,430,382,718.00
	total refunded	<b>No</b>	47	28	23	55	40	340	99
		<b>in ETB</b>	523,207,479.00	1,063,255,786.00	699,171,813	340,601,890.95	180124548	1046328137	791,132,086.90
	Rejected	<b>No</b>	7	3.00	8	6	5	271	3
		<b>in ETB</b>	11,486,385	87,916,878.05	21,787,359	253,832,669.48	12389902.8	107709312.8	189,058,789.30

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

	covered existing liability by tax	No		1.00	10	3	2	3	17
		in ETB		13,875,989.38	28517615	62375805.95	8240069.21	5911208.78	90679602.07
	transferred for the next year	No	23	19.00	10	10	9	64	64
		in ETB	133,116,532.00	107,963,575.50	34315671	41,034,657.80	102276705	783,152,661.20	1,359,512,240.00
6. customs approved VAT refund claims	total refund requested	No	51	63	21	32	50	64	26
		in ETB	4,488,181	3,736,214.10	1,470,480	2,027,754.79	6166482.53	6708726.36	7,866,268.84
	total refunded	No	21	37	10	17	11	25	4
		in ETB	3,269,609.20	1,840,029.76	374,216	589,063.36	904786.51	3369941.06	190,093.21
	Rejected	No	20	8.00	5	5	14	6	
		in ETB	909,668	1,034,679.40	331,393	570,730.54	3699653.65	136343.69	100001.69
	covered existing liability by tax	No	1		3	1			1
		in ETB	17848.67		393341.83	208208			22443.93
	transferred for the next year	No	11	18	3	9	25	52	21
		in ETB	1,051,658.07	861,504.94	371528.18	659,752.84	1562042.37	5,213,851.77	7,553,729.80
7. NGO	total refund requested	No	7	17	10	10	14	6	6
		in ETB	2,605,630.00	4,487,950.16	2,619,294.19	6,048,943.04	10485439.8	2172364.1	4,515,562.84
	total refunded	No	5	17	9	10	14	6	6
		in ETB	2,165,765.00	19,038,503.92	2,139,501.69	457,699	882440.45	2058147.46	978,584.40
	Rejected	No	2						
		in ETB	439,866.00	2,584,098.24	337,240.92	5,591,244.02	9662999.35	114216.64	3536978.43
	offsite for existing tax	No							
		in ETB							

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

	transferred for the next year	No			1					
		in ETB	80,586.00		142,551.58					
8.others	total refund requested	No	5	17	42	38	35	51	77	
		in ETB	371,122,957	612,928,997.10	1,091,866,807	415,366,083.60	329833553	773995248.6	808,633,149.30	
	total refunded	No	4	14	8	38	35	47	77	
		in ETB	243,021,963.52	309,710,103.30	152,831,199	169,852,444.30	290636434	289402750.9	684,802,469.00	
	Rejected	No	2		1				3	
		in ETB	184,736,672	301,442,286.50	3,690,654	245,513,639.30	38174617.2	483574195.3	114,710,097.70	
	covered by existing liability	No						5	1	
		in ETB					1022502.2	459619.23	9120582.45	
	transferred for the next year	No			34					
		in ETB			935344954		329601	558,683.27		
	<b>Total refund request</b>			<b>1,832,740,387.98</b>	<b>3,054,375,833.44</b>	<b>7,154,170,898.42</b>	<b>5,266,773,944.27</b>	<b>7,468,366,458.36</b>	<b>31,955,287,997.13</b>	<b>13,684,439,392.53</b>
	<b>VAT refund paid as % of refund requested</b>			<b>66%</b>	<b>65%</b>	<b>59%</b>	<b>40%</b>	<b>88%</b>	<b>78%</b>	<b>62%</b>
<b>Share of VAT withholding claim</b>			<b>27%</b>	<b>23%</b>	<b>22%</b>	<b>62%</b>	<b>86%</b>	<b>66%</b>	<b>65%</b>	

**Source:** - annual VAT refund performance report of the three branch office. Other type of VAT refund claim includes: investors those afford more than 100USD in Ethiopia, condominium housing project (since 2007 EC. served by Addis Ababa tax center), Ethiopia railway, ELP (both are VAT withholding agents allowed to use as offsetting the amt. they collected cap. Gds. parches).

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

**Table-4.3 Trends of VAT collection, refund request and VAT refund in ERCA**

Year	Total VAT revenue collected	Amounts of refund request	amounts actually refunded	amounts rejected	request to refunded
2008	8,988,180	1,348,227.0	898,818		0.667
2009	13,677,930	396.90	579.35	80.54	1.479
2010	19,311,210	675.89	1,127.56	498.96	1.68
2011	28,320.21	2,501.49	2,060.85	737.77	0.986
2012	35,151.79	2,607.50	2,628.54	2,022.91	1.032
2013	44,218.56	2,824.94	3,128.74	1,345.32	1.107
2014	55,465.62	6,555.73	6,184.86	302.75	0.946
2015	58,132.06	4,246.56	4,411.19	1,245.95	1.0785
2016	63,762.15	21,430	11,125.71	2,143.13	0.5947

Source: ERCA annual report

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

<b>Table 4.5 Total tax collection of ERCA (Federal)</b>													(In millions ETB.)	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Dome. Tax revenue	3,850.76	4,590.16	5,804.94	8,009.59	11,381.66	17,564.76	26,160.79	36,161.58	44,915.77	59,607.99	73,706.78	80,302.23	91,632.68	
VAT on dom. Transaction	1,542.83	1,819.85	2,390.30	3,243.18	4,784.04	7,382.16	10,725.02	16,147.38	21,393.90	27,474.05	35,893.26	35,863.43	39,909.08	
VAT on imports	2,489.22	2,989.30	3,541.17	4,069.52	4,204.14	6,295.77	8,778.78	12,172.83	13,775.97	16,744.51	19,572.36	22,268.63	23,853.07	
Total VAT	4,032.05	4,809.15	5,931.48	7,312.70	8,988.18	13,677.94	19,503.80	28,320.21	35,169.87	44,218.56	55,465.62	58,132.06	63,762.15	
Total dire. tax	1,681.27	2,053.46	2,646.08	3,783.61	5,396.26	8,693.44	13,149.87	17,076.23	20,211.71	27,711.02	32,596.41	38,597.73	44,105.47	
Total indirect. Tax	7,911.66	9,120.25	11,348.83	15,422.03	17,828.03	26,536.52	36,694.76	52,542.81	62,699.02	77,163.19	93,446.39	103,789.08	113,038.48	
Dom. In dire. Taxes	2,919.27	3,177.14	4,013.59	5,250.49	7,396.89	10,901.24	15,728.88	22,756.63	28,718.50	36,147.46	46,315.87	48,020.73	53,873.82	
International trade tax	5,866.62	6,651.86	8,353.86	11,242.40	12,172.44	18,092.88	24,581.33	34,487.65	39,391.63	47,078.81	54,499.00	63,947.15	68,444.91	
Total tax revenues	9,735.29	11,261.32	14,177.60	19,280.27	23,554.10	35,708.47	50,816.45	70,745.94	84,414.41	106,798.27	128,320.94	144,348.21	160,179.62	
Share of VAT to total tax	0.41	0.43	0.42	0.38	0.38	0.38	0.38	0.40	0.42	0.41	0.43	0.40	0.40	
Share of VAT to total indirect tax	0.51	0.53	0.52	0.47	0.50	0.52	0.53	0.54	0.56	0.57	0.59	0.56	0.56	
Share of VAT to intern. Trade tax	0.69	0.72	0.71	0.65	0.74	0.76	0.79	0.82	0.89	0.94	0.93	0.91	0.93	
Dome. VAT to Domestic tax rev.	0.40	0.40	0.41	0.40	0.42	0.42	0.41	0.45	0.48	0.46	0.49	0.45	0.44	

Source: ERCA annual report and MIS data for the year 2002/03-2016/17

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

**Table 4.6** Total tax to GDP, VAT to GDP and VAT to total tax revenue  
In millions ETB.

Year	GDP at current mkt. price	Total Tax collected	Tax/GDP	Total VAT collected	Total VAT/total GDP
2003	72,703.00	6,580.11	9%	1,933.09	3%
2004	85,800.00	8,539.33	10%	3,488.27	4%
2005	105,415.00	9,735.29	9%	4,032.05	4%
2006	130,334.00	11,261.32	9%	4,808.77	4%
2006/7	170,281.00	14,177.60	8%	5,931.47	3%
2007/8	245,836.00	19,280.27	8%	7,313.16	3%
2008/9	332,060.00	23,583.26	7%	8,988.19	3%
2009/10	379,135.00	35,708.47	9%	13,677.93	4%
2010/11	515,078.50	50,816.45	10%	19,503.80	4%
2011/12	747,326.50	70,745.94	9%	28,320.21	4%
2012/13	866,921.08	84,414.41	10%	35,169.87	4%
2013/14	1,060,825.38	106,798.27	10%	44,218.56	4%
2014/15	1,297,961.44	128,320.94	10%	55,465.62	4%
2015/16	1,528,044.23	144,348.21	9%	58,132.06	4%

**Source:** annual report of ERCA and MoFEC 2017/18

## Value Added Tax Refund Practices and Revenue Performance in Ethiopia

**Table-4.8 Consumption Efficiency (CE) by using total consumption expenditure for the last 14 years**

FYs	Total domestic g/s VAT	total customs VAT	GDP at Market Prices	VAT Productivity	Total consumption	VAT as a % of total consumption	C-efficiency
2003/4	372.26	2,267.57	72,703.00	3%	67,187.00	1%	4%
2004	1,220.70	2,489.22	5,800.00	9%	72,839.00	2%	11%
2005	1,542.80	2,989.30	105,415.00	10%	95,416.00	2%	11%
2006	1,819.85	3,541.17	130,334.00	9%	119,553.00	2%	10%
2007	2,390.30	4,069.52	170,281.00	9%	149,241.00	2%	11%
2008	3,243.64	4,204.14	245,836.00	9%	223,243.00	1%	10%
2009	4,784.04	6,295.77	332,060.00	10%	299,546.00	2%	11%
2010	7382.161	8,778.78	379,135.00	13%	343,933.00	2%	14%
2011	10,725.02	12,172.8	515078.54	14%	426,235.60	3%	17%
2012	16,147.38	13,775.9	747,326.50	14%	603,580.80	3%	18%
2013	21,393.90	16,744.5	866,921.08	16%	714,538.20	3%	20%
2014	27,474.05	19,572.36	1,060,825.38	17%	843,099.00	3%	22%
2015	35,893.26	22,268.63	1,297,961.44	18%	1,013,203.00	4%	24%
2016/17	35,863.43	23,853.07	1,528,044.23	16%	1,186,114.00	3%	20%

**Source:** Own Calculation, data were taken from ERCA, national statics agency and MoFEC