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COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

**THE EFFECT OF VALUE ADDED TAX ON OPERATIONAL
EFFICIENCY OF NGOS IN ADDIS ABABA**

By

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Addis Ababa, Ethiopia

A Research Proposal submitted to department of Accounting and Finance as a partial fulfillment of the requirements for MSc degree in Accounting and Finance

Thesis Approval Sheet

I, Yeshe Feyisa, hereby affirm that the thesis proposal entitled: The study examines how Value Added Tax (VAT) implementation affects operational efficiency of non-governmental organizations which operate within Addis Ababa. The research which I have conducted forms part of the requirements needed to earn my Master's Degree in Accounting and Finance at Addis Ababa University. The research includes proper citations for all ideas and contributions from other researchers and authors and scholars who have been referenced in this study.

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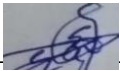
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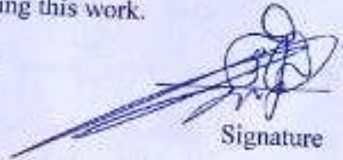
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Declaration

The document titled "The effect of Value Added Tax (VAT) on operational efficiency of non-governmental organizations which operate within Addis Ababa" received my assessment and Yeshe Feyisa completed this work under my supervision. The thesis requirement would be fulfilled by submitting this work.

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The open defence examination board member status allows me to confirm that I reviewed Yeshe Feyisa research while performing the candidate evaluation. The thesis fulfills all necessary requirements which make it suitable for awarding the Master of Science Degree in Accounting and Finance.

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The final version of the thesis needs to be submitted to the department for approval before it can receive final acceptance.

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Acronyms and Abbreviation

NGO=Non-Governmental Organization

VAT=Value Added Tax

CSO=Civil Society Organization

MoR=Ministry of Revenue

CGT= Charity Tax Group

EU= European Union

Abstract

This thesis research investigates the impact of Value Added Tax (VAT) implementation on the operational efficiency of Non-Governmental Organizations (NGOs) operating in Addis Ababa, Ethiopia. Utilizing a mixed-methods research design, the study analyzed primary data from a survey of 112 registered NGOs, representing a 100% response rate. The relationship between VAT-related variables and organizational performance was evaluated using a multiple linear regression model, which demonstrated that independent variables including compliance burden, refund timelines, and budget availability explain 62.4% of the variance in NGO operational efficiency. The empirical findings reveal that the current VAT framework creates a significant structural drain on the non-profit sector. Quantitatively, 81.3% of the surveyed NGOs perceive VAT as a moderate to very strong constraint on their operations. A critical factor in this inefficiency is the systemic delay in the tax recovery process; 80.4% of respondents reported waiting more than seven months for VAT refunds, with 37.5% of the sample experiencing delays exceeding one year. These protracted timelines result in severe liquidity constraints, forcing 73% of organizations to resort to emergency borrowing and causing project execution delays for 78% of the NGOs. Furthermore, the study identifies a direct erosion of developmental resources, with 72% of NGOs reporting a reduction in program scope or beneficiary reach due to unrecoverable VAT costs. The administrative compliance burden is equally taxing, as 68% of organizations dedicate 15 to 30 staff hours monthly exclusively to VAT-related documentation and follow-up. The research concludes that the current system undermines the principle of tax neutrality for the non-profit sector. To mitigate these challenges, the study recommends that the Ministry of Revenues (MoR) prioritize the automation of refund mechanisms and streamline exemption procedures to ensure that donor-funded resources are maximized for social impact.

Keywords: *NGO, VAT Refund, Timeline, Budget, Compliance burden, Program and Administrative Costs*

Chapter One

Introduction

1.1 Background of the Study

Value Added Tax (VAT) is a broad-based consumption tax levied on the value added at each stage of production and distribution of goods and services. Since its first introduction in France in 1954, VAT has expanded globally, with over 160 countries adopting it as part of their tax system (Ebrill et al., 2001; Keen, 2013). The popularity of VAT lies in its potential to generate substantial and stable revenue, enhance tax neutrality, and reduce reliance on trade taxes, which are often volatile (Bird & Gendron, 2007). As a result, VAT has become a cornerstone of modern fiscal systems and is now responsible for generating more than 25% of the world's tax revenue (OECD, 2020).

In Africa, VAT adoption has also been widespread. More than 80% of Sub-Saharan African countries have integrated VAT into their tax systems, with VAT contributing approximately 25–30% of total tax revenues (Keen & Lockwood, 2010). For example, countries like South Africa and Kenya report VAT as one of their largest sources of domestic revenue, supporting budgetary financing and reducing fiscal deficits (Cnossen, 2015). Despite this success, critics argue that VAT can be regressive if not designed carefully, as it disproportionately affects low-income households and organizations that cannot reclaim input VAT (Bird & Zolt, 2011).

Ethiopia introduced VAT in January 2003 through Proclamation No. 285/2002, replacing the outdated sales tax. The Ethiopian VAT system applies a standard rate of

15% to most goods and services, while basic food items, medical supplies, and agricultural inputs are zero-rated, and some sectors like education are exempt (MoR, 2016). Businesses with annual turnover exceeding 2 million birr are legally obliged to register for VAT. Since its introduction, VAT has significantly increased Ethiopia's domestic revenue mobilization. For instance, the Ministry of Revenues (MoR) reported a substantial rise in revenue collection during the first decade of VAT implementation (FDRE, 2016).

Nevertheless, the system presents challenges for certain economic actors, particularly non-governmental organizations (NGOs). By law, NGOs in Ethiopia are exempt from registering for VAT and are not required to charge VAT on their services. However, they are not exempt from paying VAT on goods and services purchased from VAT-registered suppliers (CSO Proclamation, 2022). Consequently, VAT becomes an indirect cost to NGOs, consuming part of their limited budgets and restricting their operational capacity. This problem is not unique to Ethiopia; globally, NGOs and charities have raised concerns about the burden of irrecoverable input VAT. For example, in the United Kingdom, charities collectively pay around £3.1 billion annually in VAT, of which 57% (£1.8 billion) is irrecoverable, creating a major financial burden on the sector (Charity Tax Group & Nuffield Foundation, 2011).

In the Ethiopian context, the issue is further complicated by the interpretation of Proclamation No. 285/2002, which considers the application of VAT-paid goods and services for non-taxable activities as taxable supplies in themselves. This legal provision makes VAT recovery by NGOs nearly impossible, since their activities are

predominantly non-commercial and humanitarian in nature. As Simon (2013) noted, while VAT has supported Ethiopia's fiscal decentralization and contributed to government revenue, its unintended consequences for the non-profit sector remain largely unaddressed.

NGOs play a vital role in Ethiopia's development, filling service delivery gaps in areas such as health, education, poverty alleviation, and humanitarian relief (Clark, 2000; Yeshanew, 2012). Their funding largely depends on donations, grants, and membership contributions, which are often fixed and earmarked for specific programs. When VAT is levied on their operational expenses, NGOs face budgetary shortfalls, forcing them to either scale down projects, reduce service delivery, or divert resources from core missions (Taye, 2018). This undermines their financial sustainability and weakens their contribution to national development efforts.

Globally, research has emphasized the need for governments to carefully balance VAT efficiency with equity concerns, especially for socially beneficial organizations. Ebrill et al. (2001) argued that while VAT is effective for revenue generation, exemptions and zero-ratings must be designed to avoid distorting its neutrality. Bird and Gendron (2007) similarly stressed that applying VAT uniformly without considering the unique characteristics of NGOs can create hidden costs and unintended inefficiencies.

Therefore the Ethiopian VAT system presents an inconsistency: while it strengthens government revenue and aligns with international best practices, it simultaneously imposes financial strain on NGOs that play a critical complementary role in the delivery of public goods and services. In Ethiopia, recent studies have highlighted

VAT's contribution to revenue growth and fiscal sustainability (Assefa Belay, 2022; Nassir, 2024; Gidey & Tukue, 2025). More recent scholarship emphasizes how VAT reforms, including Proclamation No. 1341/2024 and Regulation No. 570/2025, have expanded the tax base, thereby intensifying the fiscal burden on NGOs. This evolving evidence underscores the need to critically examine VAT not only as a tool of fiscal sustainability but also as a policy instrument with significant distributive consequences for organizations delivering essential social services.), but have not empirically examined how irrecoverable VAT affects NGO operational efficiency. This gap is significant because NGOs' efficiency measured in terms of budget utilization, project sustainability, and service delivery is directly undermined when VAT becomes an unrecoverable cost. Accordingly, this research seeks to fill that gap by analyzing the relationship between VAT incidence and NGO operational efficiency in Ethiopia, thereby contributing to both fiscal policy debates and the literature on non-profit sustainability

1.2 Statement of the Problem

Value Added Tax (VAT) is principally designed as a consumption tax, where the burden ultimately falls on the final consumer of goods and services (Ebrill et al., 2001; Bird & Gendron, 2007). This system generally works well for businesses that pass VAT costs onto consumers through pricing mechanisms. However, for Non-Governmental Organizations (NGOs), which largely provide goods and services free of charge or at highly subsidized rates, VAT becomes an irrecoverable input cost. Unlike commercial entities, NGOs cannot shift this tax burden to end users, meaning that they

directly absorb the costs of VAT on purchases of goods and services. This reduces the financial resources available for their core missions, such as humanitarian relief, poverty alleviation, and development programs (Taye, 2018; Yeshanew, 2012).

Although Ethiopian VAT law provides exemptions for specific humanitarian goods and services, the broader application of VAT to NGOs' operational expenses such as office supplies, utilities, professional services, and project-related procurement creates a structural financial burden (FDRE Proclamation No. 285/2002).

VAT is designed as a consumption tax meant for final consumers, but NGOs, unlike profit-driven firms, operate to deliver humanitarian and social programs. When required to pay VAT on goods and services for their activities, NGOs themselves bear the tax burden, reducing their capacity to provide essential public services.

International studies have echoed similar concerns. For instance, the Charity Tax Group in the UK found that charities pay approximately £3.1 billion annually in VAT, of which 57% is irrecoverable, significantly straining their budgets (Charity Tax Group & Nuffield Foundation, 2011). In the European Union, Ernst & Young (1998) identified systemic biases in VAT application, such as tax cascading, impediments to privatization, and unintended burdens on the voluntary sector. These findings highlight the global challenge of aligning VAT systems with the operational realities of NGOs.

In Ethiopia, however, the literature on VAT's impact on NGOs remains limited. Existing studies primarily examine VAT's effects on business enterprises, focusing on issues such as compliance costs, refund processes, and impacts on small and medium enterprises (Taylor & Francis, 2023; Mohammed, 2022; Bishubran, 2024). Very few

studies directly address the specific ways in which VAT affects the financial sustainability, program quality, and operational efficiency of NGOs. This lack of evidence creates a knowledge gap that undermines informed policy discussions and leaves NGOs with little empirical basis to advocate for reforms.

The consequences of this policy gap are significant. For NGOs operating in Ethiopia, particularly those in Addis Ababa, VAT payments on goods and services divert scarce resources away from program delivery and into tax expenditures. This leads to reduced budget allocations for both administrative and programmatic activities, undermining their ability to achieve intended outcomes. As Simon (2013) observed, while VAT has contributed to Ethiopia's revenue mobilization, its unintended consequences for non-commercial actors remain largely overlooked.

Given the vital role NGOs play in addressing social needs and complementing government development efforts (Clark, 2000; Yeshanew, 2012) the financial strain imposed by VAT represents not only a challenge to organizational efficiency but also a potential barrier to Ethiopia's broader development goals.

VAT has been widely criticized in the literature for its regressive nature and unequal impact on organizations that lack refund mechanisms. As noted by UKDiss.com (2021), VAT, being an indirect tax, tends to place a heavier burden on entities such as NGOs, which are unable to reclaim the tax on their purchases, thereby reducing the resources available for their core activities. Complementing this perspective, Al Ishaqi and Mastor (2024) conducted a bibliometric analysis of global VAT research, reviewing 481 published papers. Their study shown that while VAT has been widely

examined in various contexts, there remains a significant shortage of research focusing specifically on NGOs, particularly in developing countries. This gap underlines the need for more targeted studies that explore how VAT systems affect the operational efficiency and sustainability of NGOs in resource-constrained environments.

Therefore, this study seeks to examine the effect of VAT on the operational efficiency of NGOs in Addis Ababa. Specifically, it investigates how VAT obligations influence budget allocation, program implementation, and overall organizational performance. This study explores how Value Added Tax (VAT) obligations influence the financial and operational efficiency of NGOs in Addis Ababa. It looks at the effects of VAT on budget allocation, program implementation, and organizational performance. The study emphasizes the tension between VAT as a consumer tax and the unexpected challenges it poses for non-commercial organizations. By investigating this overlooked area, the research seeks to provide evidence that can support NGO advocacy efforts and help guide public policy changes toward a fairer tax system. The study aims to offer empirical evidence that can benefit both NGO strategies and public policy reforms.

1.3 Research Questions

Based on the objectives of the study, the following research questions are raised.

1. To what extent does VAT affect the program and administrative costs of NGOs?
2. How does the timeliness of VAT refunds influence the operational efficiency of NGOs?
3. What is the effect of VAT on the budget of NGOs?

4. How effective are VAT refunds in enhancing the operational efficiency of NGOs?
5. Does the awareness of NGOs about VAT refund procedures have any implications for their operational efficiency?
6. What is the extent of the compliance burden of VAT on NGOs?

1.4 General Objective

The general objective of this study is to examine the effect of Value Added Tax (VAT) on the operational efficiency of NGOs, with a specific focus on NGOs located in Addis Ababa.

1.4.1 Specific Objectives

This study seeks to achieve the following specific objectives:

1. To examine the extent to which VAT affects the program and administrative costs of NGOs.
2. To assess whether the timeliness of VAT refunds influences the operational efficiency of NGOs.
3. To evaluate the effect of VAT on the budget availability of NGOs.
4. To analyze the effectiveness of VAT refunds in enhancing the operational efficiency of NGOs.
5. To examine whether the awareness of NGOs about VAT refund procedures has implications for their operational efficiency.
6. To assess the compliance burden of VAT on NGOs.

1.5 Significance of the Study

This study is significant for several reasons.

First, academic significance: Existing literature on VAT in Ethiopia has mainly focused on its effects on business enterprises, compliance costs, and revenue mobilization (Mohammed, 2022; Bishubran, 2024; Simon, 2013). Very little research has examined the implications of VAT on non-governmental organizations (NGOs), despite their critical role in service delivery and development. By focusing on NGOs in Addis Ababa, this study contributes to bridging this knowledge gap and provides a foundation for further scholarly inquiry into the interaction between taxation and the non-profit sector.

Second, policy significance: The findings of this study will provide valuable insights to Ethiopian tax authorities and policymakers regarding the unintended burdens VAT places on NGOs. Such evidence is crucial for evaluating whether current VAT rules and refund mechanisms align with the government's development objectives and international best practices. The study may also serve as an input for revising tax policies to better support NGOs without undermining revenue mobilization.

Third, practical significance: For NGOs themselves, the study offers an empirical assessment of how VAT affects their financial stability, budget allocation, and operational efficiency. Understanding these effects will help NGOs adopt better financial planning strategies, improve compliance practices, and strengthen advocacy efforts aimed at minimizing the adverse impacts of VAT on their missions.

Fourth, social and developmental significance: NGOs play a vital role in addressing social needs, delivering humanitarian aid, and complementing government efforts in education, health, poverty reduction, and community development (Clark, 2000; Yeshanew, 2012). By highlighting how VAT obligations affect NGO operations, this study indirectly supports more effective service delivery to vulnerable populations. Enhancing NGO efficiency ultimately contributes to Ethiopia's broader socio-economic development goals.

In sum, this research is expected to benefit academia, policymakers, NGOs, and society at large by providing evidence-based insights into the intersection between taxation policy and non-profit organizational performance.

1.6 Operational Definition of Terms

Value Added Tax (VAT): A consumption-based tax levied at 15% in Ethiopia on the value added to goods and services at each stage of production and distribution (FDRE Proclamation No. 285/2002). In this study, VAT refers to the tax paid by NGOs on goods and services purchased from VAT-registered suppliers.

Non-Governmental Organizations (NGOs): Non-profit, non-governmental, voluntary organizations established to provide humanitarian, developmental, and social services without the primary aim of profit generation. In this study, NGOs refer specifically to those registered and operating in Addis Ababa.

Operational Efficiency: The ability of NGOs to effectively utilize their financial and non-financial resources to achieve program goals with minimal waste. For this study,

operational efficiency is measured in terms of program delivery, budget utilization, and administrative effectiveness under VAT obligations.

Program Costs: Expenditures directly related to the implementation of NGO projects and services, such as procurement of project materials, training, and field operations. In this study, program costs include VAT paid on goods and services used for program activities.

Administrative Costs: Expenditures related to the internal management of NGOs, including salaries, office rent, utilities, and supplies. This study considers VAT on these expenses as part of administrative costs.

VAT Refunds: A reimbursement mechanism through which registered taxpayers can recover VAT paid on business-related purchases. For NGOs, VAT refunds refer to the possibility (or lack thereof) of reclaiming VAT paid on goods and services procured for their activities.

Timeliness of VAT Refunds: The speed at which VAT refund claims are processed by tax authorities. In this study, it refers to whether delayed refunds affect NGOs' cash flow and operational efficiency.

Effectiveness of VAT Refunds: The degree to which VAT refund systems function as intended, enabling NGOs to recover eligible VAT payments without excessive delays, administrative hurdles, or losses.

Compliance Burden: The administrative and financial obligations NGOs face in fulfilling VAT-related requirements, such as record keeping, filing claims, and interacting with tax authorities.

Budget Availability: The amount of funds accessible to NGOs for programmatic and administrative use after accounting for VAT-related expenses. In this study, budget availability reflects the extent to which VAT obligations reduce funds available for core activities.

Awareness of VAT Refund Procedures: The extent to which NGOs and their staff understand VAT rules, eligibility criteria, and refund mechanisms. In this study, awareness is measured by the knowledge NGOs have about reclaiming VAT and its effect on their efficiency.

CHAPTER TWO

2.REVIEW OF RELATED LITERATURE

Introduction

This chapter presents a review of relevant theoretical and empirical literature related to the study. The purpose of the literature review is to provide a conceptual and analytical foundation for examining the effect of Value Added Tax (VAT) on the operational efficiency of Non-Governmental Organizations (NGOs), with particular reference to NGOs operating in Addis Ababa. By synthesizing scholarly works, policy documents, and international practices, the chapter seeks to highlight existing debates, identify gaps in knowledge, and establish the framework within which this study is situated.

The previous chapter introduced the background of VAT, its implementation in Ethiopia, and the specific challenges faced by NGOs, which are not profit-oriented entities but are nonetheless affected by VAT on their purchases of goods and services. The problem statement emphasized the financial and operational burden that VAT imposes on NGOs, potentially undermining their ability to deliver effective programs and achieve their missions.

In line with the research objectives, this chapter reviews relevant concepts, theories, and empirical findings. The literature is organized under the following major sections:

1. Conceptual review – definition, objectives, and principles of VAT; nature and characteristics of NGOs; and operational efficiency in the context of non-profit organizations.

2. Theoretical review – an overview of taxation theories relevant to VAT and NGOs, such as the benefit theory of taxation, ability-to-pay theory, and tax neutrality.
3. Empirical review – evidence from international and Ethiopian studies on the effect of VAT on NGOs and other non-profit entities, focusing on program costs, budget allocation, compliance burden, and refund mechanisms.
4. Synthesis and research gap – an assessment of what is already known, the limitations of prior studies, and the knowledge gaps that this research intends to fill.

Through this structure, the chapter lays the groundwork for analyzing how VAT policies and practices affect the operational efficiency of NGOs in Ethiopia, and why this subject requires more focused academic inquiry.

2.1 Conceptual Review

Value Added Tax (VAT) is a broad-based consumption tax levied on the value added at each stage of production and distribution of goods and services (Bird & Gendron, 2007). Unlike a traditional sales tax, which is imposed only at the point of final sale, VAT is applied throughout the supply chain, ensuring taxation occurs incrementally at each stage. This mechanism increases revenue predictability for governments and reduces opportunities for tax evasion through the self-enforcing credit-invoice system (Ebrill et al., 2001). The primary objectives of VAT include revenue generation to provide a stable source of government income; equity by distributing the tax burden fairly among consumers; and economic efficiency by minimizing distortions in market

decisions (Keen & Lockwood, 2010; Cnossen, 2015). VAT is guided by several fundamental principles: neutrality, ensuring it does not distort decisions between business entities or sectors; transparency, where tax is clearly shown and accounted for on invoices; the destination principle, meaning VAT is levied where goods or services are consumed; and self-enforcement, which relies on businesses reporting both inputs and outputs to prevent evasion (OECD, 2019).

Ethiopia implemented VAT under Proclamation No. 285/2002, replacing the sales tax system, with a standard rate of 15%. While the legislation provides zero-rating for goods such as exports, agricultural inputs, and essential medical supplies, and exemptions for certain services like education and health, VAT is broadly applied to most goods and services purchased by organizations, including NGOs (FDRE, 2002; Yemisrach, 2014). Despite its contribution to revenue collection, VAT presents challenges for NGOs, which operate on limited budgets and cannot pass tax costs onto end-users. VAT on inputs such as office equipment, utilities, and project materials represents an unrecoverable expense, directly reducing funds available for mission-critical activities (André van Wykine, 2024). This additional financial burden can constrain programmatic activities, reduce the scope of services, and threaten long-term organizational sustainability.

Non-Governmental Organizations (NGOs) are voluntary, non-profit, and autonomous entities established to serve public interests rather than generate profits for owners or shareholders (Salamon & Anheier, 1997; Lewis & Kanji, 2009). NGOs are characterized by five key attributes: organized and institutionalized structure, private

governance independent from government, non-profit distribution of surplus revenues, self-governance allowing internal decision-making, and voluntary participation fostering stakeholder engagement (Salamon & Anheier, 1997). NGOs primarily rely on external funding sources, including grants, donations, membership fees, and sometimes government contracts, making them particularly vulnerable to financial shocks caused by taxation (Yeshanew, 2012; Clark, 2000). VAT obligations, when applied to NGOs, effectively reduce the financial resources available for programs, limit operational flexibility, and increase the reliance on donor funding for routine expenditures.

Operational efficiency in NGOs refers to the ability to deliver programs and achieve objectives with minimal waste of resources while maintaining quality and timeliness (Kaplan, 2001; Letts, Ryan, & Grossman, 1999). It encompasses the effective allocation of resources between administrative and programmatic costs, proper compliance with regulations, financial sustainability, and timely service delivery. The imposition of VAT can undermine operational efficiency through increased program and administrative costs, reduced budget availability, delays in refund processing, and heightened compliance requirements (André van Wykine, 2024; Bird & Gendron, 2007). For NGOs, VAT represents a cost that cannot be transferred to beneficiaries, meaning the organization bears the full burden, which can negatively affect both short-term operations and long-term sustainability (Taye, 2018). Additionally, complex VAT refund procedures, delayed reimbursements, and lack of awareness regarding refund eligibility may strain NGOs' finances, forcing reductions in program activities or service delivery (Simon, 2013).

The taxation of NGOs varies significantly across countries, reflecting differences in fiscal policy, legal frameworks, and the perceived role of NGOs in national development. While most jurisdictions recognize the public benefit provided by NGOs and grant some level of tax relief, the scope and effectiveness of these provisions differ (Salamon, 2010; Owens, 2013). In Uganda, NGOs are formally exempt from income tax only after applying to the Uganda Revenue Authority (URA) and must comply with VAT at 18%. Refunds are permitted for eligible expenditures but require extensive documentation (Uganda Revenue Authority, 2021). Kenya provides exemptions on specific goods and services and allows VAT refunds for other purchases within six months, contingent on detailed record-keeping (Kenya Revenue Authority, 2020). In Spain and Belgium, NGOs face standard VAT rates of 21%, with reduced or zero-rated rates for essential goods. Refund procedures exist but impose significant administrative burdens due to long documentation requirements and strict filing deadlines (European Commission, 2020; Belgian VAT Code, Article 44 & 56). Switzerland and South Africa adopt more NGO-friendly approaches, with lower standard VAT rates and longer or more accessible refund periods (OECD, 2019; SARS, 2021). Similarly, Egypt and Nigeria provide exemptions and allow refunds within strict timelines, requiring NGOs to demonstrate their charitable purpose and maintain comprehensive records (Egyptian Tax Authority, 2020; Federal Inland Revenue Service, 2021). Austria requires NGOs to submit quarterly refund applications online, emphasizing proper accounting and timely filing under Article 21 of the Austrian VAT Act (UStG).

Overall, international experiences show that, while income tax exemptions are common for NGOs, VAT continues to pose a significant operational burden due to delays in refunds, complex compliance requirements, and limited awareness of refund procedures. These factors undermine NGOs' operational efficiency by diverting resources from program delivery (Bird & Gendron, 2007; Keen, 2013). In Ethiopia, although VAT exemptions exist for humanitarian aid and relief supplies, VAT applies broadly to goods and services consumed by NGOs, creating financial and administrative pressures (FDRE VAT Proclamation No. 285/2002). Unlike in countries such as Kenya or South Africa, where timely VAT relief mechanisms exist, Ethiopian NGOs often face uncertainty and bureaucratic delays, reducing budget availability for essential projects. Comparative analysis suggests that Ethiopia could benefit from adopting VAT practices that balance government revenue needs with the operational sustainability of NGOs, ensuring that the non-profit sector can continue to provide vital social services effectively.

2.2 Theoretical Literature Review

2.2.1 Concept and Definition of Value Added Tax in NGO

In the context of Non-Governmental Organizations (NGOs) or Civil Society Organizations (CSOs), VAT application poses unique challenges. CSOs often receive favorable tax treatment for certain activities. For instance, under Ethiopian law, CSOs are exempt from income tax on grants and membership fees, which are considered non-commercial sources of revenue (FDRE, 2022). They may also qualify for customs duty exemptions if they meet specific criteria outlined by the government. However, this

preferential treatment does not extend to income derived from economic or commercial activities, which remain subject to taxation.

In addition to income and customs duties, CSOs and NGOs are subject to transaction-based taxes, specifically Turnover Tax (TOT) or Value Added Tax (VAT), depending on the annual value of goods and services acquired. Organizations exceeding the threshold for registration must comply with VAT regulations, which include charging VAT on taxable sales (if any), maintaining proper accounting records, and claiming input VAT credits where eligible (Proclamation No. 285/2002). For NGOs, VAT obligations can represent a significant financial and administrative burden, because unlike commercial enterprises, they generally cannot pass the tax burden to end beneficiaries, making VAT an effective input cost that reduces resources available for programmatic activities (André van Wykine, 2024; Taye, 2018).

Therefore, understanding VAT from a theoretical perspective involves recognizing its dual role: as a tool for efficient revenue collection for governments, and as a potential cost and compliance challenge for organizations, particularly non-profit entities. This dual nature underscores the need to examine VAT's effect on operational efficiency, budget allocation, and program delivery within NGOs, especially in contexts such as Ethiopia where refund mechanisms and exemptions are limited or cumbersome.

2.2.2 Hypotheses of the Study

This study looks at how Value Added Tax (VAT) obligations affect the financial and operational efficiency of NGOs in Addis. The literature on Value Added Tax (VAT) consistently highlights its dual role: while it mobilizes government revenue, it also

imposes unintended burdens on non-commercial actors such as NGOs. Globally, charities and voluntary organizations have reported significant financial strain due to irrecoverable VAT costs (Charity Tax Group & Nuffield Foundation, 2011; Ernst & Young, 1998). In Ethiopia, VAT law (FDRE Proclamation No. 285/2002) exempts certain humanitarian goods but continues to apply to operational expenses, creating a mismatch between VAT's design as a consumption tax and the realities faced by NGOs (Simon, 2013). Building on theoretical perspectives (Ebrill et al., 2001; Bird & Gendron, 2007) and empirical findings, this study formulates the following hypotheses: First, since NGOs cannot shift VAT costs onto consumers, VAT is expected to significantly increase program and administrative expenditures, thereby reducing resources available for service delivery. Second, the timeliness of VAT refunds is hypothesized to have a positive effect on operational efficiency, as delays in refund processing create liquidity constraints and undermine financial planning (IMF reports on VAT refund systems). Third, VAT obligations are anticipated to negatively affect budget availability, diverting funds away from programmatic activities and weakening organizational efficiency. Fourth, awareness of VAT refund procedures among NGO staff is expected to improve operational efficiency, as limited knowledge and procedural complexity often lead to underutilization of refund opportunities (Mohammed, 2022; Bishubran, 2024). Fifth, compliance burdens associated with VAT including documentation, audits, and administrative requirements — are hypothesized to significantly increase NGOs' operational costs, echoing findings from studies on SMEs in Ethiopia (Taylor & Francis, 2023). Finally, effective VAT refund mechanisms

are expected to enhance operational efficiency by reducing irrecoverable costs and freeing resources for program implementation.

To achieve the above objectives, the study tests the following hypotheses, formulated based on theoretical and empirical literature:

Non-governmental organizations (NGOs) in Addis Ababa play a crucial role in addressing social and developmental needs, often operating with limited resources and relying heavily on donor funding. These organizations are increasingly subject to complex tax regulations, including Value Added Tax (VAT), which can significantly impact their financial sustainability and operational effectiveness. The imposition of VAT on NGOs, designed primarily as a consumer tax, presents unique challenges, particularly concerning budget allocation, program implementation, and overall organizational performance.

This study investigates the multifaceted effects of VAT obligations on the financial and operational efficiency of NGOs in Addis Ababa. It examines how VAT influences resource allocation, program delivery, and the ability of these organizations to achieve their missions. By analyzing these impacts, the research aims to contribute to a better understanding of the challenges faced by NGOs and to provide evidence that can inform advocacy efforts and policy reforms.

Timely VAT refunds are critical for sustaining organizational cash flow, strengthening budget credibility, and improving operational efficiency both in Ethiopia and globally. When refunds are delayed, NGOs and businesses face liquidity constraints that disrupt procurement, program delivery, and financial planning. In Ethiopia, Seada Kedir (2018)

and Addisalem Sisay (2021) found that refund practices directly affect revenue performance and institutional trust in tax administration, underscoring the importance of efficient refund systems for budget reliability.

From a budget perspective, delayed refunds distort deficit measurement; create arrears, and force governments or organizations to reallocate funds away from planned activities. The IMF (Harrison & Krellove, 2005; IMF, 2021) emphasized that VAT refunds are the “Achilles heel” of VAT systems, where delays undermine fiscal credibility and treasury operations. The UN DESA (2024) guidance highlights that refunds must be budgeted annually to avoid liquidity crises and ensure fiscal transparency. Efficient refund systems therefore improve budget predictability, reduce spending overruns, and allow organizations to reinvest refunded amounts into ongoing activities without interruption.

The impact extends to administrative and program costs. When refunds are delayed, NGOs and firms must dedicate additional staff time and resources to follow up with tax authorities, prepare repeated documentation, and manage cash flow shortfalls. This increases administrative overhead and diverts funds from programmatic activities. Program costs rise because delayed liquidity forces organizations to cut or postpone activities, negotiate short-term financing, or absorb exchange rate losses.

There is also a significant compliance burden. Complex refund procedures, excessive documentation requirements, and unpredictable timelines increase transaction costs for taxpayers. As IMF (2021) notes, poor refund practices create opportunities for corruption and fraud, while discouraging voluntary compliance. Efficient refund

systems reduce compliance costs, strengthen trust in tax administration, and encourage broader participation in the formal economy.

At the enterprise level, She, Sun & Yan (2025) showed that VAT credit refunds alleviate cash flow pressures, reduce operational costs, and strengthen international competitiveness, while Shan (2024) demonstrated productivity gains in China linked directly to refund efficiency. Together, these findings underscore that timely VAT refunds reduce financial strain, improve budget credibility, lower administrative and program costs, and ease compliance burdens worldwide, making them a cornerstone of effective fiscal management for NGOs, businesses, and governments alike.

H1: VAT significant effect on program and administrative costs of NGOs.

H2: The timeliness of VAT refunds has a significant positive effect on the operational efficiency of NGOs.

H3: VAT has a significant negative effect on budget, thereby reduces the operational efficiency of NGOs.

H4: Awareness of VAT refund procedures significantly improves the operational efficiency of NGOs.

H5: VAT significantly increases the compliance burden of NGOs.

H6: Effective VAT refunds significantly enhance the operational efficiency of NGOs.

For Non-Governmental Organizations (NGOs), VAT registration carries additional implications. While many NGOs are exempt from charging VAT on their services due to their non-profit nature, they may still incur VAT on purchases of goods and services. If registered, NGOs can claim input VAT credits, reducing the financial burden of their

operations. However, the registration and compliance process can be administratively complex, requiring careful record-keeping, timely filing, and adherence to MoR regulations. Delays or errors in registration or reporting can lead to financial penalties, disrupt cash flow, and reduce the resources available for programmatic activities, ultimately affecting the operational efficiency of NGOs (André van Wykine, 2024).

Therefore, VAT registration serves as both a mechanism for legal compliance and revenue generation and a potential source of administrative and financial challenges for organizations, particularly for NGOs operating under limited budgets and relying on donor funding. Understanding the registration process and its implications is essential for assessing how VAT influences the operational efficiency and sustainability of non-profit organizations in Ethiopia.

2.2.3 NGO Administrative Costs vs. Program Costs

Non-Governmental Organizations (NGOs) are required to carefully balance administrative costs and program costs to ensure that resources are primarily directed toward their core missions. According to Article 90 of the Civil Society Organizations (CSO) Proclamation, “Any charity or society shall allocate not less than 80 percent of the expenses in the budget year for the implementation of its purposes and an amount not exceeding 20 percent for its administrative activities” (Users’ Manual for Charities and Societies Law, 2019). This provision underscores the regulatory emphasis on maximizing resources devoted to programmatic activities while maintaining essential administrative functions.

Administrative costs are defined as expenses not directly related to project activities but necessary to ensure the organization's continued operations. These include salaries and benefits of administrative personnel, office consumables, depreciation and maintenance of fixed assets, rent, utilities, bank service charges, audit fees, communication costs such as internet and fax, advertisement, and vehicle acquisition and maintenance (CSO Directive 847/2021). Effective management of administrative costs is critical because excessive administrative spending can divert resources from programs, reduce donor confidence, and compromise organizational efficiency.

In contrast, program costs refer to expenditures directly associated with achieving the NGO's mission, including project implementation, outreach, and service delivery. Ensuring that a high proportion of the budget is allocated to program costs aligns with the regulatory requirement and reflects sound financial management practices. The balance between administrative and program costs is monitored through budgeting, which serves as a quantitative expression of a proposed plan of action for a specific period. A budget provides a financial roadmap, translating strategic goals and operational plans into measurable targets expressed in monetary terms, facilitating effective allocation of resources, coordination, and communication across organizational departments (Baril, 2001).

For NGOs operating under Value Added Tax (VAT) obligations, the distinction between administrative and program costs becomes even more significant. VAT paid on inputs for either administrative or program-related activities effectively increases the cost of operations. Since NGOs generally cannot pass this tax burden to beneficiaries,

VAT payments can reduce the funds available for both administrative and program expenditures, potentially affecting operational efficiency, service delivery, and compliance with statutory requirements (André van Wykine, 2024; Taye, 2018). Therefore, understanding and managing administrative versus program costs is essential for NGOs to maintain financial sustainability, achieve mission objectives, and comply with regulatory standards in Ethiopia.

2.2.4 Budget Classification

Budgeting is a critical tool for resource allocation, financial planning, and performance management in NGOs, particularly under the constraints imposed by VAT and limited funding. Budgets are generally classified into program budgets and administrative budgets, each serving distinct purposes.

A program budget is a financial plan specifically designed to allocate resources to a particular program or project within an organization. Unlike a general organizational budget that covers all activities, a program budget focuses exclusively on the costs and revenues associated with a specific initiative. It outlines anticipated expenses for personnel, materials, activities, and other items necessary for the program's successful implementation. Program budgets serve as a strategic tool for program managers, enabling them to track spending, monitor progress against financial targets, and make informed decisions to ensure that programs achieve their intended goals within the allocated resources. By providing a detailed financial roadmap for the lifecycle of a program, program budgets help ensure accountability, transparency, and efficient utilization of funds (PMI, 2021).

An administrative budget, by contrast, covers projected expenses associated with the management and operation of the organization's core administrative functions. These include salaries and benefits for administrative staff, office supplies, rent, utilities, insurance, legal and accounting fees, and other operational costs necessary to maintain the organization's infrastructure and facilitate smooth functioning. Administrative budgets provide a framework for controlling overhead costs, ensuring that administrative spending remains within limits, supports the overall mission, and do not divert excessive resources from programmatic activities (Baril, 2001; CSO Directive 847/2021).

For NGOs, effective classification and management of program versus administrative budgets is particularly important under the impact of VAT. VAT payments on goods and services used for either program or administrative purposes increase operational costs, reducing the funds available for achieving program objectives. Therefore, NGOs must carefully monitor and plan their budgets to maintain compliance with statutory limits such as allocating at least 80% of resources to programs and no more than 20% to administrative activities while optimizing resource use and minimizing the financial burden of VAT on their operations (André van Wykine, 2024; Taye, 2018).

2.2.5 Compliance Burden

Compliance burden refers to the costs and resources that organizations must expend to adhere to laws, regulations, standards, and other mandatory requirements. These burdens encompass both direct costs, such as professional fees for accountants or tax consultants, document preparation, and investment in computerized accounting or VAT reporting systems, and indirect costs, such as the time and effort required to understand complex regulations, complete required paperwork, implement new administrative processes, and undergo audits or inspections to demonstrate compliance (OECD, 2019). For Non-Governmental Organizations (NGOs), compliance with Value Added Tax (VAT) regulations can create a significant operational challenge. Although many NGOs are exempt from charging VAT on their services, they often incur VAT on purchases of goods and services for both programmatic and administrative purposes. The process of tracking eligible expenses, maintaining detailed invoices, submitting timely VAT returns, and claiming input VAT refunds demands both financial and human resources, which could otherwise be allocated to program activities (André van Wykine, 2024).

A high compliance burden can disproportionately affect smaller NGOs or those with limited administrative capacity, potentially hindering operational efficiency, innovation, and service delivery. The indirect costs associated with VAT compliance such as staff time spent on documentation, reconciliation, and follow-up on delayed refunds can reduce the funds available for programs, delay project implementation, and increase the risk of errors or penalties (Taye, 2018). In this context, minimizing

compliance burdens while maintaining accountability and regulatory adherence is crucial for ensuring that NGOs can maximize the impact of donor funds and sustain their mission driven activities.

2.2.6 Related Theory Review

Public Finance Theory

This theory gives a solid base for figuring out how government tax rules shape the money side of things for groups like NGOs. It looks at their day to day work and overall effectiveness too. The main idea here is that governments pull in money using tools like Value Added Tax. These tools then hit different parts of the economy and places that provide services. Musgrave and Musgrave pointed this out back in 1989. VAT works as a wide reaching tax on what people buy. It raises prices for the stuff NGOs need to get hold of. That cuts into the donor money they have left for actual programs. Stiglitz made a case in 2000 that taxes mess with how resources get used. They also bump up costs in ways that hurt. This matters a lot for NGOs since they stick to tight budgets. They depend so much on outside cash too. Public Finance Theory talks about fiscal incidence as well. That is the way it traces who really ends up paying the tax bill. When NGOs cannot get VAT back, they take the full hit. This limits how flexible their finances can be. It also holds back their service delivery in smooth ways. Bird and Zolt covered this in 2005. Such issues stand out in poorer nations. There NGOs step in for key areas like health care and schools. They handle aid efforts and social safety nets too.

Public Finance Theory points out the admin side of taxes as important. It notes that following VAT rules takes effort. Things like keeping records, filing reports, and facing audits add up. These tasks create extra costs in time and money for any organization. Staff end up spending hours on them instead of main work. That pulls down how well things run overall. Atkinson and Stiglitz said in 1980 that tax setups can help or hurt performance. It depends on what breaks they offer, like skips on taxes or refunds. Simple steps can make a difference too. In the nonprofit world, this ties into how governments view these groups. Tax choices show if the state values what NGOs do for society. Salamon wrote in 1995 that heavy tax loads without relief cause problems. NGOs face money squeezes then. Their programs do not reach as far. Buying supplies and giving services gets less efficient. On the flip side, skips on taxes or ways to reclaim VAT help a lot. They free up more resources for the real mission. That boosts how long these groups can keep going.

All this from Public Finance Theory backs up why we should study VATs impact on NGO efficiency. It shows clear links between taxes and available funds. Admin loads go up too. Cost setups change in ways that affect goals. In the end, NGOs find it harder to meet what they set out to do.

Ability to Pay Theory in Taxation and NGOs

The Ability-to-Pay Theory argues that taxes should be levied according to a taxpayer's economic capacity, ensuring equity by imposing heavier burdens on those with greater resources. This principle is often justified through egalitarian and utilitarian reasoning,

emphasizing that progressive taxation minimizes social sacrifice and redistributes wealth more fairly.

For NGOs, this theory is significant because it underpins tax exemptions and preferential treatments. Many governments recognize that NGOs lack profit motives and operate with limited financial capacity, so applying the ability to pay principle justifies reduced tax burdens. This ensures NGOs can allocate more resources toward their social missions rather than fiscal obligations. In Ethiopia, for example, NGOs often benefit from exemptions on VAT or income tax precisely because their ability to pay is constrained compared to for-profit entities.

In practice, the ability-to-pay framework strengthens NGOs' legitimacy by aligning fiscal policy with social justice. It acknowledges that NGOs contribute to public welfare without generating commercial profits, thus their taxation should reflect their limited financial base. Balancing equity with efficiency remains a main pressure in applying this theory to NGOs.

Tax Neutrality Theory

VAT has a significant impact on NGO performance, particularly when examined through the lens of tax neutrality theory, which emphasizes that taxation should not distort organizational choices or efficiency. Scholars argue that VAT, while designed to be neutral, often creates distortions in the nonprofit sector by increasing compliance costs and limiting financial flexibility. Gjems-Onstad (1995) found that VAT rules impose administrative burdens on NGOs, reducing their operational efficiency and diverting resources away from service delivery. Similarly, Schneider, Stähler, and

Thunecke (2024) demonstrate that VAT is not fully neutral, as it generates production and service distortions that undermine NGOs' ability to allocate resources effectively. TaxDev (2023) further notes that VAT changes affect markups and productive structures, meaning NGOs face higher costs for inputs and reduced competitiveness in delivering social services. Taken together, these findings show that VAT can compromise neutrality in NGO taxation, thereby affecting their performance and weakening their capacity to fulfill public welfare missions.

2.3 Empirical Review

2.3.1 Foreign Studies

Several studies across the globe have examined the impact of Value Added Tax (VAT) on businesses and non-profit organizations, revealing both the benefits and challenges associated with its implementation.

Small and Medium Enterprises (SMEs) and VAT Compliance: Wadesango (2020) investigated the impact of VAT on small and medium enterprises in Zimbabwe and found that VAT compliance significantly affects SMEs due to complexity, high implementation costs, and challenging economic conditions. Compliance with VAT rules and procedures directly impacts SMEs' cost structure, production capacity, and growth prospects. The study also highlighted that the high administrative burden and lack of clear understanding of VAT obligations may contribute to unethical tax avoidance practices, indicating that VAT imposes both financial and operational constraints on smaller entities.

VAT Awareness among Medium Taxpayers in Ethiopia: A master's thesis submitted in 2024 examined awareness of VAT administration and regulations among medium taxpayers in Ethiopia. The study revealed that 50% of respondents had gaps in knowledge regarding VAT rules, regulations, and directives issued by the Ministry of Revenues (MoR). This underscores the need for additional training and educational programs to enhance taxpayer confidence and ensure proper VAT compliance.

VAT Challenges for NGOs: Barnard (2018) studied VAT compliance provisions for NGOs in South Africa. The research revealed that NGOs face significant challenges due to limited technical and financial resources and ambiguity in VAT legislation. These factors create an environment in which non-compliance carries substantial financial risks and fosters misunderstanding of VAT provisions applicable to non-profit organizations, which can undermine operational efficiency.

VAT and Inflation in Ethiopia: Dabat (2024) examined the relationship between VAT and inflation in Ethiopia, finding that VAT contributes directly to inflationary pressures in both the short and long term. Since VAT increases the cost of goods and services, these higher costs can be transferred to consumers, influencing overall price levels in the economy.

VAT and Charitable Organizations: According to research by the Charity Tax Group and Nuffield Foundation (2011), charities in the UK pay approximately £3.1 billion annually in input VAT, of which around 57% (£1.8 billion) is irrecoverable. This represents a substantial financial burden, limiting charities' ability to allocate resources to their core missions. In the year 2018, London Economic notes that charities are

effectively treated as final consumers because they often cannot reclaim VAT on purchases related to exempt or non-taxable services. This unfair treatment hinders their capacity to maximize the impact of donor funds and reduces operational efficiency.

VAT and Input/Output Mechanism: VAT is designed as a consumption tax, levied on the value added at each stage of production and distribution, with the ultimate burden falling on the final consumer (Bird & Li, 2008). Registered businesses can reclaim input VAT on purchases, offsetting it against output VAT collected on sales. However, for entities like NGOs that provide exempt services or non-taxable activities, VAT paid on inputs cannot be reclaimed, creating additional financial pressure. Proclamation No. 285/2002 in Ethiopia specifies that if a registered person purchases goods or services accompanied by VAT and apply them to uses other than taxable activities, it is still considered a supply in the course of taxable activity, further complicating compliance and recovery for NGOs.

In summary, international empirical evidence illustrates that while VAT is a critical source of government revenue, it poses unique challenges to SMEs and NGOs, particularly regarding compliance costs, unrecoverable input VAT, and administrative complexity. These challenges are often amplified for non-profit organizations, which cannot pass VAT costs to beneficiaries, thereby reducing operational efficiency and constraining mission-related activities.

2.3.2 The Role of NGOs in Economic Development and Social Welfare

Non-Governmental Organizations (NGOs) play a multifaceted and indispensable role in promoting economic development, social welfare, and community empowerment across the globe. Smith and Jones (2023) highlight that NGOs serve as critical intermediaries between individuals, governments, and the private sector, facilitating communication, collaboration, and innovative solutions to pressing social issues. By fostering social capital, building trust, and encouraging civic engagement, NGOs act as catalysts for positive social transformation. In addition, they contribute to experimentation in service delivery, testing new approaches to complex problems and pushing the boundaries of traditional development models.

Similarly, Brown and Williams (2022) underscore the critical importance of NGOs in addressing unmet social needs, particularly in marginalized and underserved communities. NGOs provide essential services such as healthcare, education, food security, and poverty alleviation, while simultaneously advocating for social justice and the rights of vulnerable groups. Their work empowers communities by building local capacity and fostering participatory development approaches, ensuring sustainable and inclusive growth. The authors conclude that NGOs are indispensable partners in creating equitable, resilient, and socially just societies.

Governance and accountability are also central to NGOs' effectiveness. Johnson and Thompson (2020) emphasize that strong governance structures, transparent financial management, and ethical decision-making are essential to maintaining public trust and achieving organizational goals. Effective oversight, clear conflict of interest policies,

and systematic performance evaluations enable NGOs to navigate complex regulatory environments and sustain operational integrity, ultimately enhancing their social impact.

In Ethiopia, NGOs have become key drivers of sustainable development and social progress. Abebe and Desta (2023) highlight that NGOs contribute significantly to poverty reduction, environmental conservation, and community empowerment, especially in rural areas. Through partnerships with local communities, NGOs build local capacity, promote sustainable livelihood initiatives, and implement development programs aligned with the Sustainable Development Goals (SDGs). Similarly, Walley and McDonald (2016) emphasize the role of NGOs in advancing health and development, particularly in regions where government services are limited. NGOs facilitate community participation, adapt programs to local needs, train healthcare providers, and advocate for policy changes, thereby bridging gaps in service delivery and enhancing long-term sustainability.

A study by Berhanu Denu and Getachew Zewdie (2013) further demonstrates how administrative costs and budget allocation affect NGO operations in Ethiopia. Their research indicates that NGOs often reduce staff salaries, purchase lower-cost materials, and relocate offices to minimize administrative costs. While these measures can alleviate financial pressures, taxes such as VAT particularly when refunds are delayed or unavailable negatively impact program funding, reduce service quality, and hinder effective project implementation.

Moreover, NGOs' flexibility, grassroots focus, and ability to respond to specific community needs enable them to address social challenges in ways that governments or private sector actors cannot. Nyang'au, Nyangosi, Oenga, and Suleiman highlight that NGOs fill critical service gaps, support women's empowerment, and foster community development, demonstrating the sector's unique strengths in driving social progress. In Ethiopia, NGOs have also played pivotal roles in implementing Ministry of Health policies, particularly in integrating basic curative and maternal-child health services, reflecting their capacity to operationalize national strategies at the community level (Belshaw & Coyle, 2018).

Overall, NGOs serve as agents of change, service providers, advocates, and innovators, playing an essential role in economic development, social welfare, and community empowerment. Their work not only complements government services but also strengthens civic participation, promotes equity, and enhances the effectiveness of development interventions. Understanding the critical role of NGOs provides essential context for analyzing how VAT and other regulatory requirements affect their operational efficiency and capacity to deliver on their missions.

In Ethiopia, the Value Added Tax (VAT) system, established under Proclamation No. 285/2002 and later amended by Proclamation No. 1157/2019, has become a major source of government revenue. While VAT provides predictable income and reduces tax evasion, its application to Non-Governmental Organizations (NGOs) has raised concerns regarding operational efficiency, budget allocation, and financial sustainability (FDRE, 2002; Yemisrach, 2014). Unlike profit-driven businesses that can

pass on VAT costs to end-users, NGOs cannot transfer the tax burden. Consequently, VAT paid on purchases represents an unrecoverable expense for many NGOs, directly reducing the resources available for programmatic and administrative activities (André van Wykine, 2024).

Empirical studies highlight the challenges faced by Ethiopian NGOs in navigating VAT regulations. Research by Simon (2013) indicates that delays in VAT refund processing create cash flow constraints, often forcing NGOs to defer project implementation or reduce service scope. The lack of awareness and limited capacity to comply with VAT documentation requirements further exacerbate these financial pressures, undermining operational efficiency. Similarly, Taye (2018) finds that NGOs' inability to fully recover input VAT increases program costs and diminishes funds available for critical interventions, affecting the quality and reach of social services.

Studies on VAT compliance among small and medium enterprises (SMEs) in Ethiopia provide indirect insights into NGO challenges. Isubalew Dabat (2024) examines VAT and inflation, showing that administrative complexities, delays in refund processing, and compliance burdens contribute to increased operational costs. While SMEs can often adjust pricing to maintain margins, NGOs face constraints because donor-funded budgets are fixed, leading to a direct trade-off between tax payments and service delivery.

USAID-supported projects illustrate a practical mechanism for VAT mitigation in Ethiopia. According to USAID Ethiopia VAT refund procedures, partner NGOs can reclaim VAT on purchases above a de minimis threshold of US\$500, provided they

submit invoices and supporting contractual documents to the Ministry of Revenues (MoR). While these guidelines enable partial relief, the procedural requirements including compiling original invoices, stamping copies, and attaching contracts create administrative burdens and require significant staff time (USAID, Ethiopia VAT Refund Procedure Manual). For many NGOs, these requirements limit the practical benefit of VAT refunds and contribute to increased operational complexity.

Furthermore, studies by Berhanu Denu and Getachew Zewdie (2013) indicate that taxes such as VAT, when not refunded promptly, can distort NGO budget allocations. NGOs are often compelled to reduce administrative spending, minimize staff compensation, and purchase lower-quality materials to maintain program operations. These adjustments can negatively affect organizational efficiency, program quality, and donor confidence. The inability to recover VAT on essential project-related goods and services ranging from office equipment to project materials creates a situation where NGOs are effectively treated as final consumers of taxed goods, further straining limited resources (London Economic, 2011).

International comparisons provide additional context. Similar to Ethiopia, NGOs in countries such as Uganda, Kenya, and South Africa experience difficulties with VAT compliance and refunds. However, countries like South Africa offer extended refund windows and clearer procedural guidance, reducing the administrative burden and enabling NGOs to allocate more resources toward program delivery (Isél Barnard, 2018; SARS, 2021). These examples suggest that reforms in Ethiopia's VAT system,

particularly simplifying refund procedures and improving awareness among NGOs, could enhance operational efficiency and service delivery.

In summary, empirical evidence indicates that VAT obligations in Ethiopia have a direct and measurable impact on NGOs' operational efficiency, administrative and program costs, and budget allocation. Delays in refund processing, procedural complexities, and limited organizational capacity exacerbate financial pressures, compelling NGOs to reallocate resources in ways that may compromise program quality and organizational sustainability. This highlights the need for targeted policy interventions to reduce the unintended financial burden of VAT on NGOs and optimize their contribution to social and economic development in Ethiopia.

2.3.3 Non-Profit Organizations and Taxation

The taxation of non-profit organizations (NGOs) has long been a complex and contested issue, as governments seek to balance revenue collection with the recognition of the public benefit provided by these entities. Ole Gjems-Onstad (n.d.) critically examines the use of "tax expenditures" as a tool for analyzing government support to the third sector, highlighting that the concept often oversimplifies the complex interactions between NGOs and the state. The research emphasizes that indirect taxes, particularly Value Added Tax (VAT), can introduce hidden burdens on NGOs, reducing their financial flexibility and potentially compromising their independence and legitimacy. Gjems-Onstad argues that NPOs must advocate for clear justifications for taxation, reconsider exemptions, treat direct subsidies as tax back-payments, and adopt a broader perspective that evaluates the systemic implications of tax policies on the third sector.

In his subsequent work, *Value Added Taxation and the Third Sector*, Gjems-Onstad focuses specifically on VAT, highlighting the challenges faced by NPOs in complying with complex tax regulations. The study finds that VAT can significantly affect the financial sustainability of NPOs by increasing operational costs, imposing administrative burdens, and limiting access to tax breaks available to profit-driven entities. Compliance requirements, including detailed invoicing, record-keeping, and refund procedures, often require resources that NPOs would otherwise allocate to programmatic activities, thereby reducing their efficiency and effectiveness. Gjems-Onstad recommends that policymakers design VAT regulations tailored to the unique

characteristics of NPOs, increase transparency in exemptions and tax breaks, and involve NPOs in the formulation of tax policy to safeguard their capacity to deliver social services.

Supporting this perspective, the Survey of Tax Laws Affecting Non-Governmental Organizations in Central and Eastern Europe, Second Edition provides a regional overview of taxation frameworks and their implications for NGO operations. The study finds that although income tax exemptions are commonly granted, indirect taxes such as VAT frequently remain a significant financial burden. Delays in refunds, cumbersome documentation requirements, and complex compliance obligations undermine NPOs' operational efficiency and constrain the funds available for program implementation. By comparing tax regimes across multiple countries, the study underscores the importance of carefully calibrated tax policies that recognize the public benefit role of NGOs while ensuring accountability and transparency in the allocation of tax exemptions.

Collectively, these empirical studies reveal a recurring theme: VAT, while essential for government revenue, can unintentionally penalize non-profits by converting them into de facto final consumers of taxed goods and services. This treatment diminishes their financial capacity to fund programs, increases administrative overhead, and risks diverting resources away from social impact activities. The literature emphasizes the need for tax policy reforms that balance fiscal objectives with the operational realities of NPOs, including streamlined VAT refund processes, capacity-building initiatives for

compliance, and tailored tax incentives that preserve the autonomy and sustainability of the third sector (Gjems-Onstad, n.d.; Survey of Tax Laws, 2nd Ed.).

In the Ethiopian context, these insights are particularly relevant. NGOs face broad application of VAT under Proclamation No. 285/2002, with exemptions limited to humanitarian aid and certain relief services. Procedural complexities and delays in VAT refunds exacerbate financial pressures, forcing NGOs to reallocate limited budgets away from programmatic activities and potentially compromising service delivery. Understanding these empirical findings highlights the necessity of designing VAT policies that account for the distinctive operational and financial characteristics of NGOs, thereby ensuring their continued contribution to social and economic development.

2.3.4 VAT and Its Impact on the Financial Performance of NGOs

Value Added Tax (VAT) is widely acknowledged as a tool for revenue generation and economic regulation, but its application can have unintended consequences for non-profit organizations (NGOs), which operate with limited financial resources and depend heavily on donations, grants, and external funding. Empirical evidence suggests that VAT obligations can directly and indirectly affect the financial performance, operational capacity, and sustainability of NGOs.

Mohammed (2022) analyzed the implementation of VAT in Iran since 2008 and found that the tax negatively affected key economic performance indicators of enterprises, including production levels, profitability margins, employment, and overall business size in Khorasan Razavi, North, and South Khorasan provinces. Approximately 80% of

respondents indicated that VAT hindered operational performance across these metrics. While the study focused on businesses, the findings are relevant to NGOs, as the imposition of VAT on purchased goods and services effectively reduces available resources for mission-critical activities.

Similarly, Yongjiu Liu (2022) examined the effects of VAT rate reductions in China during 2018–2019 using a quasi-natural experiment and found that lower VAT rates significantly decreased production and operating costs, particularly for high-cost, non-state-owned enterprises. This research illustrates that VAT levels directly influence operating expenditures, a principle that extends to NGOs: high VAT obligations increase operational costs, while reductions or exemptions can free resources for programmatic activities. However, Liu also observed that benefits were unevenly distributed, with smaller and less-developed enterprises benefiting less, suggesting that NGOs in resource-constrained regions may experience disproportionate VAT-related burdens.

Benson (2016) highlighted that VAT imposes substantial financial burdens on charities, particularly those reliant on donations and limited funding. VAT on goods and a service purchased by charities reduces operational budgets, often forcing organizations to cut programs or decrease the quality of services delivered to beneficiaries. This effect is especially pronounced for organizations serving marginalized populations, which face increased demand for services alongside constrained funding.

Parker (2020) discussed the broader economic consequences of VAT on charitable giving. When VAT raises consumer prices, disposable income declines, potentially

reducing donations to NGOs. This behavioral shift can further strain NGOs' financial resources, particularly during economic downturns when demand for social services often rises. Parker emphasized that VAT not only affects operational costs but also indirectly influences the flow of external funding crucial to NGOs' sustainability.

Brown and Green (2021) examined case studies of NGOs in arts, health, and social services, finding that VAT obligations disproportionately affect organizations with diverse income streams, including commercial activities. Their research indicates that consistent VAT exemptions or relief measures would improve financial stability, reduce operational risk, and encourage innovation in program delivery and fundraising strategies.

In a South African context, Barnard (2017) investigated the challenges NGOs face in complying with VAT regulations. The study revealed that NGOs struggle with limited technical and financial resources, difficulties in classifying activities, and complex procedures for claiming input VAT. Barnard recommended simplified legislation, clearer guidelines, and direct government support to enable NGOs to navigate VAT obligations efficiently while maintaining their service delivery commitments.

Overall, the literature demonstrates that VAT can have significant adverse effects on NGOs' financial performance by increasing operational costs, reducing program budgets, and complicating compliance. These impacts highlight the necessity for tailored VAT policies, timely refund mechanisms, and support systems for NGOs to maintain operational efficiency and continue delivering essential social services

(Mohammed, 2022; Liu, 2022; Benson, 2016; Parker, 2020; Brown & Green, 2021; Barnard, 2017).

2.3.5 VAT and Compliance Costs

The administration of Value Added Tax (VAT) imposes both direct and indirect costs on organizations, affecting resource allocation, operational efficiency, and financial sustainability. These costs are collectively referred to as compliance costs, which encompass the financial, technical, and administrative efforts required to adhere to VAT regulations.

Optimality and Efficiency of Taxation

Bhatia (1998) outlined criteria for optimal taxation, emphasizing three major principles: minimizing the resource costs of tax compliance for both authorities and taxpayers, ensuring equity through ability-to-pay and benefits-received measures, and achieving economic efficiency. These criteria indicate that while governments often focus on revenue collection, the burden on taxpayers—including NGOs—is frequently overlooked. Decisions regarding tax composition, direct versus indirect taxation, and rate schedules must therefore consider the disproportionate impacts on resource-constrained organizations.

Legal Frameworks and NGO Sustainability

Muhamed Zulkhibri (2012) highlighted that the legal and regulatory framework significantly affects the financial sustainability of NGOs. Taxation policies, including VAT, influence NGOs' operational viability by imposing limitations on fundraising and restricting engagement in economic activities. While income generated from non-

profit activities may be exempt or partially exempt from taxes, VAT on inputs and certain transactions can substantially increase operational costs. Providing partial VAT exemptions or preferential treatment, such as exemption from customs duties on imported goods used for public benefit, can alleviate financial pressures and support long-term sustainability.

Impact of VAT on NGOs

Ole Gjems-Onstad (1992) emphasized that VAT, even when exempted for NGOs, is not entirely tax-free. Exemption from VAT prevents NGOs from claiming input VAT on purchases, effectively increasing costs and indirectly taxing the organization through higher procurement prices. This input VAT burden is particularly significant for NGOs that rely on purchased goods and services to deliver programs. Furthermore, transactions involving taxable persons can create cascading taxation effects, where VAT cannot be reclaimed, compounding financial strain.

Banja Luka (2006) illustrated these challenges in the context of EU VAT law, noting that NGOs must often maintain accountants and tax specialists to comply with complex regulations. NGOs generating income above statutory thresholds are required to register for VAT, with penalties for non-compliance. Even when income is below the threshold, NGOs may encounter difficulties in voluntary registration due to administrative hurdles, highlighting the significant compliance burden imposed on the sector.

Economic and Operational Effects

Studies in multiple contexts demonstrate the broader economic impact of VAT compliance. Jasenka Bubić (2016) found that changes in VAT rates significantly affect company liquidity and financial ratios, exacerbating challenges for organizations with limited resources. Similarly, Stefan Boeters (2015) showed that structural VAT reforms, such as the elimination of reduced rates, can have pronounced effects at the industry level, influencing costs, consumption, and welfare. Andrikopoulos et al. (1993) observed that VAT affects consumption patterns, raising consumer prices and altering expenditure allocation across goods and services.

In developing and transitional economies, VAT compliance presents additional challenges. Metcalf (1995) and Bird (2005) highlighted issues such as management and settlement costs, labor supply effects, and the political economy of VAT administration. Self-assessment systems, common in many developing and transitional economies, require sophisticated bookkeeping and record-keeping systems, which are particularly burdensome for NGOs and small businesses lacking technical capacity.

VAT compliance imposes both financial and administrative costs on organizations, disproportionately affecting NGOs that rely on purchased goods and services to deliver programs. While VAT exemptions may relieve direct tax obligations, the inability to reclaim input VAT indirectly increases operational expenses. Legal frameworks, administrative requirements, and rate structures all contribute to the compliance burden, emphasizing the need for tailored VAT policies, simplified procedures, and support mechanisms for NGOs. Minimizing compliance costs is essential to ensure that NGOs

can focus resources on programmatic activities rather than regulatory obligations, promoting financial sustainability and effective service delivery.

2.3.6 Literature Gap

Previous studies on Value Added Tax (VAT) primarily focused on business entities, with limited attention given to non-governmental organizations (NGOs). While some research addressed the compliance burden of VAT (Barnard, I. (2017) few studies have examined the unique challenges and operational implications of VAT on NGOs.

This study aims to bridge this gap by investigating the additional burden of VAT on NGOs, specifically assessing its impact on their operational efficiency in Addis Ababa, which highlighted VAT-related costs in general, this study provides a comprehensive assessment by analyzing multiple dimensions, including compliance burden, VAT refund mechanisms, awareness of VAT refund procedures, budget allocation, and program versus administrative costs.

By examining these factors, this research seeks to contribute to tax administration reforms and enhance the effectiveness of VAT policies for NGOs. In this study, compliance burden, awareness and timelines of VAT refund, and budgetary allocations for program and administrative costs are treated as independent variables, while operational efficiency serves as the dependent variable. This approach allows for a more nuanced understanding of how VAT affects the day-to-day functioning and financial sustainability of NGOs.

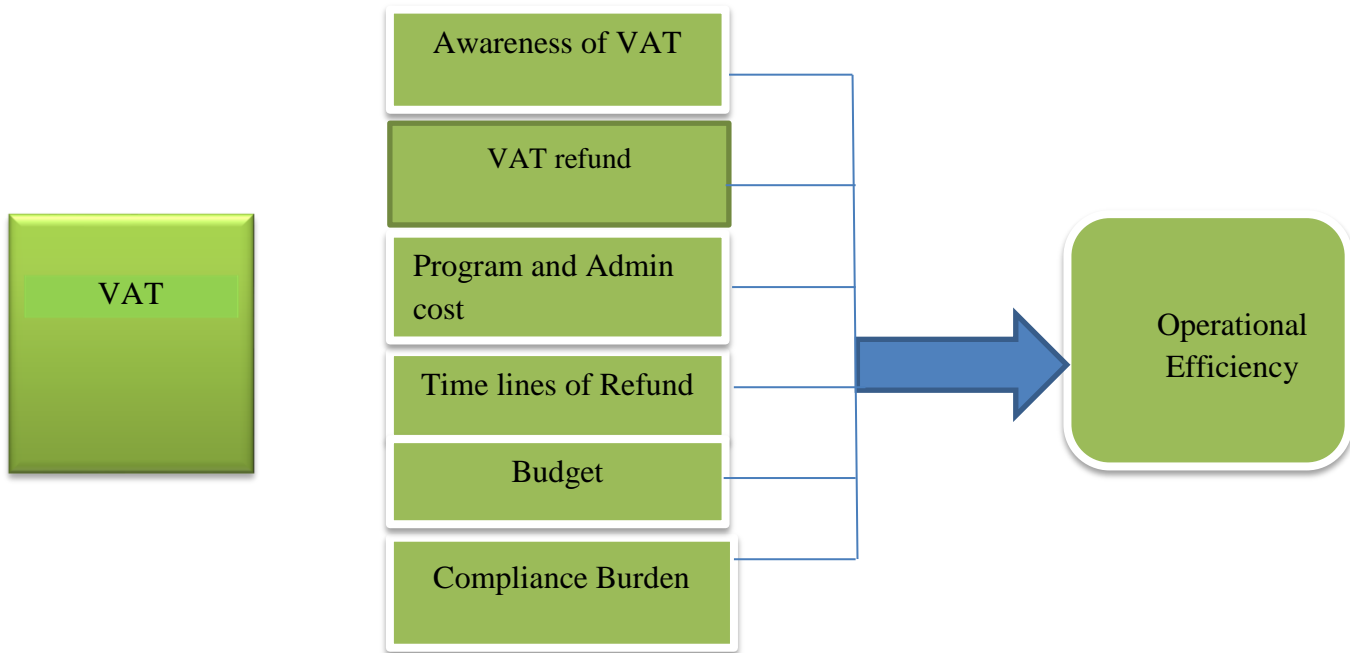
2.3.7 Conceptual Framework

Based on the literature review and identified research gaps, it is evident that VAT imposes unique challenges on NGOs, affecting both their financial operations and service delivery. While previous studies have focused on general businesses or compliance burdens, there is limited empirical evidence on how VAT influences operational efficiency within the non-profit sector in Ethiopia. This underscores the need for a structured framework to examine the relationship between VAT-related factors such as Compliance burden, VAT refunds, awareness of VAT refund procedures, and budgetary allocations for program and administrative costs—and the operational performance of NGOs.

The conceptual framework derived from this study provides a visual and analytical representation of these relationships, guiding the empirical investigation and facilitating a clear understanding of how VAT affects NGO efficiency. By systematically linking independent variables (compliance burden, VAT refund mechanisms, awareness, timelines, budget allocations) to the dependent variable (operational efficiency), the framework lays the foundation for testing hypotheses and drawing meaningful conclusions relevant to both policy and practice.

Independent Variables

Dependent Variable



Explanation:

Independent variables: VAT, Awareness of VAT, VAT Refund, Program & Administrative Costs, Timelines of Refund, Budget, Compliance Burden.

Dependent variable: Operational Efficiency of NGOs.

All independent variables are hypothesized to influence operational efficiency, directly or indirectly.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

The primary objective of this study is to investigate the effect of Value Added Tax (VAT) on the operational performance of Non-Governmental Organizations (NGOs) in Addis Ababa, Ethiopia. Specifically, the study examines how VAT obligations influence program and administrative costs, budget availability, and overall operational efficiency, as well as how NGOs manage VAT compliance and refund processes. This chapter presents the methodology adopted to achieve the research objectives and answer the research questions outlined in Chapter One. The discussion covers the research design, target population, sampling techniques, data sources, data collection instruments, variables measured, methods of data analysis, and ethical considerations that guided the research process.

3.2 Description of the Study Area

Addis Ababa is one of the capital city administrative areas of Ethiopia, the capital of Ethiopia. Geographically, the center of all international officials is located.

Ababa serves as a major commercial and residential hub. It is also home to African Union and European Union.

Addis Ababa is subdivided into 11 Sub-city (districts) and has a total population of approximately 5,000,000 residents, according to the latest population estimates by the Addis Ababa City Administration (2023). The area is characterized by a mix of

residential neighborhoods, commercial centers, and hospitality establishments, as well as significant infrastructure development.

From a socio-economic perspective, Addis Ababa is one of the fastest-growing areas, attracting both local and international organizations due to its accessibility and strategic location. According to data from the Addis Ababa City Administration Finance Office (2024), 157 Non-Governmental Organizations (NGOs) are registered and actively operating within the sub-city. These NGOs work in diverse sectors, including education, health, humanitarian aid, poverty reduction, and community development, and thus play a crucial role in improving the livelihoods of the local population.

Addis Ababa was selected as the study area for this research because it hosts a relatively high concentration of NGOs, has well-established administrative structures, and represents a dynamic socio-economic setting where VAT obligations and compliance challenges are highly relevant. Studying NGOs in this sub-city provides a representative understanding of how VAT affects operational efficiency in urban Ethiopian contexts, thereby enabling findings that can inform both local and national policy discussions.

3.3 Research Approach

Research approaches can generally be categorized as qualitative, quantitative, and mixed-methods approaches.

A qualitative approach is used when the researcher seeks to explore phenomena in-depth without quantifying results, focusing instead on rich descriptions and understanding of participants' experiences (Creswell, 2009). This approach is most

suitable for studies aiming to generate theories, explore meanings, or investigate complex social processes.

A quantitative approach involves the use of numerical data, measurement, and statistical analysis to test hypotheses, examine relationships, and identify patterns. It is particularly useful for determining cause-and-effect relationships, reducing variables to measurable constructs, and validating theories through objective evidence (Creswell, 2009).

A mixed-methods approach combines both qualitative and quantitative techniques in a single study to gain a more comprehensive understanding of the research problem. This approach enables triangulation, where findings from one method can complement and validate those from the other, thereby increasing the credibility of results (Creswell & Plano Clark, 2017).

Given the nature of this study, which aimed to test hypotheses, the effect of VAT on the budget available for timely VAT returns, VAT refunds, and program and administrative costs help quantify the impact of VAT on NGOs' operational performance. The research used a mixed-methods approach. Researchers collected quantitative data using structured questionnaires to measure VAT's impact on program and administrative costs, budget allocation, and operational efficiency. Qualitative data will be gathered through interviews with key NGO personnel to provide contextual insights and a better understanding of the challenges and coping mechanisms related to VAT compliance. Using a mixed-methods approach ensures a holistic view of the research

problem, strengthens the validity of findings through triangulation, and facilitates a richer interpretation of results

3.4 Target Population

The target population for this study comprises all legally registered Non-Governmental Organizations (NGOs) operating in Addis Ababa. The research focus on Addis Ababa due to time and resource constraint, most of NGOs head quarter office located in Addis Ababa because the it is the capital city of Ethiopia and it hosts a diverse mix of local and international NGOs engaged in a range of sectors, including education, health, humanitarian relief, and community development. This diversity makes Addis Ababa a suitable representation of the broader NGO landscape in Ethiopia, thereby allowing findings to be generalizable to other urban contexts within the city.

The sampling frame the list from which the sample was drawn was obtained from the Addis Ababa City Administration Finance Office, which maintains and annually updates the official registry of NGOs operating legally within the city. Access to this list was granted through a formal request to the Finance Office. According to the data provided, 157 NGOs were registered and actively operating in Addis Ababa at the time of data collection and select 112 NGOs.

This clearly defined and reliable population frame ensured that all eligible NGOs had an equal chance of being selected as part of the study's sample, thereby improving the representativeness of the results.

3.5 Sampling Technique and Sample Size Determination

To ensure representativeness, this study employed a combination of probability and non-probability sampling techniques. Probability sampling was applied using systematic random sampling to select NGOs from the official registry obtained from the Addis Ababa City Administration Finance Office. This approach ensures that every NGO in the population has an equal and known chance of selection, minimizing sampling bias (Kothari, 2004).

In cases where access to key respondents within selected NGOs was limited, purposive sampling was used to target finance officers, program managers, or accountant's individuals most knowledgeable about VAT-related transactions and organizational operations. This mixed approach ensures both statistical representativeness and the inclusion of respondents who can provide the most relevant and reliable data.

The sample size was calculated using the finite population sample size determination formula provided by Kothari (2004):

We use the formula:

$$n = \frac{z^2 \cdot p \cdot (1 - p) \cdot N}{z^2 \cdot p \cdot (1 - p) + e^2 \cdot (N - 1)}$$

Given:

$$z = 1.96, p = 0.5, e = 0.05, N = 157$$

$$z^2 = 3.8416, \quad p(1 - p) = 0.25, \quad z^2 \cdot p(1 - p) = 0.9604$$

$$\text{Numerator: } 0.9604 \times 157 = 150.7828$$

$$\text{Denominator: } 0.9604 + 0.0025 \times 156 = 0.9604 + 0.39 = 1.3504$$

$$n = \frac{150.7828}{1.3504} \approx 111.65$$

111.65

Where:

n = sample size

N = population size (157 NGOs)

p = estimated proportion of population with the attribute (assumed 0.5 for maximum variability)

q = (1 - p)

e = margin of error (0.05)

Z = standard normal variate at 95% confidence level (1.96)

Substituting the values:

Thus, a sample of 112 NGOs will be selected for this study. Within each NGO, one respondent (Finance Manager or Accountant, Finance officer and program manager) will be surveyed to capture multiple perspectives on VAT-related operational effects, resulting in approximately 112 respondents.

This sampling method balances statistical rigor with practical feasibility, ensuring that the sample is representative of the population while capturing meaningful insights from key decision-makers within the organizations.

3.6 Data Types and Sources

To achieve the research objectives, this study primarily relies on quantitative data, supported by qualitative insights for contextual understanding.

Primary Data:

The main source of data will be structured questionnaires administered to finance officers or accountants from each selected NGO. These respondents are chosen because they are directly involved in financial transactions, VAT compliance, and reporting, making them the most reliable sources of information regarding the operational impacts of VAT. In line with the sampling procedure, one questionnaire will be administered per NGO, targeting the finance department.

Secondary Data:

Complementary data will be obtained from NGOs' audited financial reports, VAT-related documents (such as refund applications and tax invoices), and official records from the Addis Ababa City Administration Finance Office. In addition, relevant laws and proclamations, VAT Proclamation No. 285/2016 and its amendments, as well as scholarly articles and empirical studies, will be reviewed to provide background and support analysis.

The combination of these data sources ensures both reliability and validity, while also enabling triangulation of results between self-reported information and official financial and policy documents (Creswell, 2014).

3.7 Data Analysis and Presentation

The data collected in this study was analyzed using descriptive statistics and regression analysis. Descriptive statistics, including frequency, percentage, mean, and standard deviation, were used to summarize and describe the main features of the data.

To determine the relative effect of VAT on the operational efficiency of NGOs, a multiple regression model was employed. Quantitative data were presented using tables, while qualitative data were explained through narrative descriptions.

The operational efficiency of NGOs was measured by comparing the annual VAT paid with the total annual expenditure of the organization. The analysis was conducted using SPSS software.

3.8 Model Specification

In order to achieve the objectives of the study, a linear regression model was used. Since the study examined the effect of a dependent variable on more than one independent variable, and the outcome was continuous, a linear regression model was considered appropriate (Gujarati, 2004). The study employed the linear regression method to identify the effect of VAT on the operational efficiency of NGOs.

The regression model was specified as follows:

$$OE_i = \beta_0 + \beta_1 CB + \beta_2 WR + \beta_3 TLR + \beta_4 PAC + \beta_5 BG + \mu_i$$

Where:-

OE = Operational Efficiency

CB = Compliance Burden

WR = Awareness of VAT Refund

TLR = Timeline of VAT Refund

PAC = Program and Administrative costs

BG = Budget

VR=VAT refund

μ = Error term

3.9 Variable Measurement

To analyze the impact of VAT on NGO operational efficiency, key independent variables such as VAT, awareness, refunds, costs, timelines, budget, and compliance burden are defined and measured against the dependent variable, operational efficiency.

To measure the variable effectively the researcher employe this measurement

Variable	Measurement	Scale
VAT	NGO activities are subject to VAT (yes/no)	Binary
Awareness of VAT	Staff knowledge of VAT rules, regulation	Ordinal (Likert)
VAT Refund	Existence of refund mechanism VAT successfully refunded	Ordinal (Likert)

Program & Administrative Costs	Payment(procurement) by VAT invoice	Ratio
Timelines of Refund	Months/Year	Ration
Budget	Budget	Ratio
Compliance Burden	Documentation	Ordinal (Likert)
Operational Efficiency of NGO	Cost of VAT	Ordinal (Likert)

3.10 Model Assumption Test

The researcher checked the validity of the regression model by conducting various diagnostic tests using SPSS version 24. These tests ensured that the model satisfied the classical assumptions of linear regression.

Homoscedasticity Test

Homoscedasticity was tested to verify that the variance of the error terms was constant across all levels of the independent variables. This ensured that the error terms were not influenced by the values of the independent variables.

Autocorrelation Test

Autocorrelation was examined to confirm that the errors were not correlated with each other. This meant that residuals from one observation were independent of residuals from other observations.

Multicollinearity Test

Multicollinearity was tested to ensure that there was no perfect linear relationship

among the independent variables. This ensured that no independent variable was a linear combination of the others.

Normality Test

Normality was assessed to confirm that the error terms were normally distributed with a mean of zero, indicating a symmetrical, bell-shaped distribution.

Linearity Test

Linearity was tested to verify that the relationship between the dependent variable and the independent variables was linear, meaning that changes in the dependent variable were proportional to changes in the independent variables.

3.11 Reliability and Validity of the Test

Validity refers to the extent to which a method accurately measured what it was intended to measure. It indicates how well the collected data covered the actual scope of the study. In other words, validity reflects the degree to which the scores obtained from a measure represented the variables they were intended to measure Gujarati (2004).

Face validity was assessed to determine whether the instrument appeared to be related to the specific constructs under study. Content validity was evaluated to ensure that the instrument adequately covered the construct of interest (Gujarati, 2004).

Reliability refers to the consistency of a measurement. A test was considered reliable if it produced the same results when repeated under similar conditions. Test-retest reliability was conducted before administering the instrument to verify that it yielded consistent results over time.

3.12 Ethical Considerations

This study adhered to established ethical principles to ensure the protection of participants' rights and the integrity of the research process.

Informed Consent

Informed consent was obtained from all participants prior to their involvement in the study. Participants were provided with comprehensive information regarding the study's objectives, procedures, potential risks, and benefits. They were assured of their right to withdraw from the study at any time without facing any negative consequences. This approach aligns with ethical guidelines that emphasize transparency and respect for participants' autonomy.

Voluntary Participation

Participation in the study was entirely voluntary. No coercion or undue influence was exerted on potential participants. They were informed that their decision to participate or not would not affect their relationship with the researcher or any associated institutions. This practice is consistent with ethical standards that prioritize voluntary participation in research.

Confidentiality and Anonymity

All data collected during the study were treated with the utmost confidentiality. Identifying information was removed to ensure anonymity, and data were securely stored to prevent unauthorized access. These measures are in line with ethical principles that safeguard participants' privacy and confidentiality.

Minimization of Harm

Efforts were made to minimize any potential harm to participants. The study was designed to avoid physical, psychological, or social risks. Participants were monitored for any adverse effects, and appropriate measures were taken to address any concerns promptly. This commitment reflects ethical considerations that aim to protect participants from harm

Ethical Oversight

The study protocol was reviewed and approved by an institutional ethics review board to ensure compliance with ethical standards and guidelines. This oversight is crucial for maintaining the ethical integrity of research involving human subjects.

CHAPTER FOUR

4.1 Data Analysis and interpretation

Building on the foundation established in the preceding chapters, this section presents the empirical analysis of the study. The earlier chapters provided a comprehensive review of relevant literature, which helped to contextualize the research topic and identify critical knowledge gaps. Based on this review, the research problem was clearly defined, along with the formulation of research objectives, hypotheses, and the selection of an appropriate research design.

This chapter focuses on the analysis of the data collected through the survey. It includes a presentation of descriptive statistics to summarize key characteristics of the dataset, followed by correlation analysis to explore relationships among variables. Additionally, tests for normality and other statistical assumptions are conducted to assess the suitability of the data for further modeling and inferential analysis. These procedures are essential to ensure the validity and reliability of the analytical model employed in the study.

4.2 Survey Distribution and Respondent Rate

This study was based on a survey of 112 respondents. The sample constitutes the target population which was calculated based on Kothari (2004) formula in chapter three. In the beginning, 15 questionnaires were given to 15 respondents which have been checked for completeness, consistency and language. As a result, necessary adjustments were done before the actual data collected. After that, the total of 112 questionnaires were administered and distributed to the whole respondents at the end of

the fieldwork, a total of 112 of usable questionnaires were returned that represents 100% response rate and all questionnaires were used in the analysis. Kothari (2004) stated that, a response rate of 50% is sufficient, while a response rate greater than 70% is very good. This implies that based on these assertions; the response rate for this study was 100% which is reasonably very good. To increase the research ethics, the researcher was including all resulting responses on the outcomes of analyses of the data collected during the study and make interpretations accordingly.

Table 1 Respondent rate

Position	Sample Size	Returned	Non-Returned
Finance officer ,Finance and Admin Manager	112	112	0

Source, Own Survey Data2025

4.3 Descriptive analysis of the study

To attain the objectives of the study, the researcher employed purposive sampling to select respondents from a total population of 112 Non-government organizations. Data were collected using a structured questionnaire designed to capture responses across key variables, each represented by proxy questions. A total of 112 questionnaires were distributed, of which 112 were successfully returned, resulting in a strong response rate that supports the reliability of the findings. The remaining respondents did not return the questionnaire. The collected data were analyzed using SPSS version 24, and the results are presented and discussed in the following sections of this chapter.

4.4 Reliability of Test

The reliability of the questionnaire was evaluated by using Cronbach's Alpha, a measure of internal consistency. The result generated a Cronbach's Alpha value of 0.789 across 53 items, according to different research books Cronbach Alpha above 0.7 is consider acceptable and indicate the questioner administered good the result show that 0.789 very good this show that the items included in the questionnaire are very consistent in measuring the underlying constructs of the study, according to widely accepted standards, a Cronbach's.

Therefore, the questioner used in this study can be considered statistically sound and suitable for further analysis.

Table 2 Measurement of Reliability Analysis

Reliability Statistics	
Cronbach's Alpha	N of Items
.789	53

Source, Own Survey Data2025

4.5 Demographic character of respondents

This study employed a systematic random sampling methodology targeting a sample of 112 respondents, determined using Kothari's (2004) sample size formula as outlined in Chapter Three. Prior to full-scale data collection, a pilot test was conducted by distributing 15 questionnaires to a preliminary group of respondents. These test responses were reviewed for completeness, consistency, and clarity of language. Based

on the feedback, necessary revisions were made to improve the questionnaire's reliability and comprehensibility.

Following the test phase, the finalized questionnaire was administered to the full sample. At the conclusion of the fieldwork, 112 usable questionnaires were returned, yielding a response rate of 100%. According to Kothari (2004), a response rate of 50% is considered adequate, while rates exceeding 70% are deemed very well. Therefore, the response rate achieved in this study is considered highly satisfactory and indicative of strong participant engagement.

Table 3 Demography character of respondents

To uphold research ethics and ensure transparency, all valid responses were included in the analysis. The researcher committed to interpreting the findings based solely on the data collected, thereby enhancing the credibility and integrity of the study's outcomes.

Code	Category	Frequency	Percent	Valid Percent	Cumulative Percent
1	Male	61	54.5	54.5	54.5
2	Female	51	45.5	45.5	100
Total		112	100	100	

Source, own survey 2025

Table 3 presents the gender distribution of respondents. Out of 112 respondents, 54.5% were male and 45.5% were female. This suggests a fairly balanced participation between genders, indicating that both perspectives are represented in the study. The result aligns with findings by Taye (2018) and Wondimu (2019), who observed a growing gender balance in finance and administrative roles within NGOs operating in Addis Ababa. Such diversity may contribute positively to inclusive financial decision-making and compliance practices. In line with the research theme (VAT refund and operational performance of NGOs): Gender balance in NGO administration and finance roles can affect awareness and compliance with taxation procedures. Studies such as Wondimu (2019) and Mekonnen (2020) found that both male and female finance officers participate equally in tax reporting and compliance processes in Ethiopian NGOs. Some earlier studies noted gender disparities in access to finance and training, which may indirectly influence VAT awareness and compliance. For instance, UNDP (2018) emphasized that women in management roles often face limited access to capacity-building programs, which may affect their understanding of tax laws. However, the relatively balanced gender proportion in this study aligns with the increasing representation of women in managerial and financial positions within the NGO sector, as highlighted by Taye (2018) in discussions about administrative capacity and transparency in non-profit organizations in Ethiopia.

Table 4 Descriptive statistics variable of the study

Code	Age Group (years)	Frequency	Percent	Valid Percent	Cumulative Percent
1	≤ 25	15	13.4	13.4	13.4
2	26–30	18	16.1	16.1	29.5
3	31–35	20	17.9	17.9	47.4
4	36–40	21	18.8	18.8	66.2
5	41–45	16	14.3	14.3	80.5
6	46–50	12	10.7	10.7	91.2
7	Above 50	10	8.8	8.8	100
Total		112	100	100	

As presented in Table 4, most respondents (36.7%) were aged between 31 and 40 years, followed by 26–30 years (16.1%) and 41–45 years (14.3%). This indicates that the majority of the participants were mid-career professionals who are likely to possess substantial experience in NGO financial operations. This age composition aligns with findings by Taye (2018) and Mulugeta (2020), who observed that employees in this age group are more familiar with VAT refund procedures and compliance issues. The relatively small number of respondents above 50 years may suggest that senior managers are less directly involved in VAT administration tasks, while younger staff (below 25) has limited practical exposure.

Table 5 Educational qualification

Code	Educational Qualification	Frequency	Percent	Valid Percent	Cumulative Percent
1	College Diploma	24	21.4	21.4	21.4
2	Undergraduate Degree (BA/BSc)	46	41.1	41.1	62.5
3	Master's Degree (MA/MSc)	35	31.3	31.3	93.8
4	PhD	7	6.3	6.3	100
Total		112	100	100	

As presented in Table 5, most respondents hold an undergraduate degree (41.1%), followed by those with a master's degree (31.3%). The results indicate that a majority of the respondents possess tertiary-level education, implying that the workforce within NGOs in Addis Ababa is generally well-educated. This educational profile suggests that respondents are capable of understanding complex VAT regulations and compliance procedures.

These findings are consistent with studies by Taye (2018), Asmare (2017), and Wondimu (2019), which showed that educational attainment enhances tax literacy and compliance efficiency among NGO financial staff. Consequently, the relatively high educational qualifications of respondents in this study may positively contribute to accurate VAT record-keeping, awareness of refund policies, and effective engagement with MoR.

Table 6 Thematic Area

Code	Thematic Area	Frequency	Percent	Valid Percent	Cumulative Percent
1	Health	18	16.1	16.1	16.1
2	Education	22	19.6	19.6	35.7
3	Agriculture / Food Security	16	14.3	14.3	50
4	Natural Resource / Environment	14	12.5	12.5	62.5
5	Livelihoods Development	20	17.9	17.9	80.4
6	Multi-sector / Integrated Areas	22	19.6	19.6	100
Total		112	100	100	

As shown in Table 6, the participating NGOs operated across diverse thematic areas. The highest proportions were from the education (19.6%) and multi-sectoral (19.6%) fields, followed by livelihoods development (17.9%) and health (16.1%). Smaller shares were recorded for agriculture/food security (14.3%) and natural resource/environment programs (12.5%).

The distribution suggests that VAT-related practices are examined across different sectors, each with unique operational characteristics. This diversity strengthens the representativeness of the study and aligns with prior observations by Taye (2018) and Wondimu (2019) that Ethiopian NGOs increasingly operate in multi-sectorial domains. Additionally, literature highlights that education and health-focused NGOs, which form a large part of the sample, tend to face higher VAT exposure due to their procurement-

heavy operations (Asmare, 2017; Bird & Gendron, 2007). Hence, the present study’s sectorial composition is appropriate for assessing VAT refund challenges and their impact on NGO performance.

Table 7 Year of operation

Code	Years of Operation	Frequency	Percent	Valid Percent	Cumulative Percent
1	Less than 5 years	22	19.6	19.6	19.6
2	5–10 years	30	26.8	26.8	46.4
3	11–15 years	28	25	25	71.4
4	Above 15 years	32	28.6	28.6	100
Total		112	100	100	

As presented in Table 7, a considerable proportion of NGOs (28.6%) have operated for more than 15 years, followed by 26.8% that have been active for 5–10 years, and 25.0% with 11–15 years of operation. Only 19.6% of organizations have been established for less than five years.

This distribution implies that most NGOs in the sample are well-established and have long operational experience in Ethiopia. Such maturity suggests that these organizations have accumulated substantial institutional knowledge and practical experience with VAT regulations, refund procedures, and compliance systems.

Table 8 Descriptive Statistics

Code	Response Option	Frequency	Percent	Valid Percent	Cumulative Percent
1	Not at all	12	10.7	10.7	10.7
2	To a small extent	20	17.9	17.9	28.6
3	To a moderate extent	26	23.2	23.2	51.8
4	To a great extent	30	26.8	26.8	78.6
5	To a very great extent	24	21.4	21.4	100
Total		112	100	100	

As shown in Table 8, most respondents indicated that their NGOs are affected by VAT payments, with 26.8% reporting a great extent and 21.4% a very great extent. Only 10.7% of organizations reported not being affected at all. The mean rating of 3.30 on a 5-point scale demonstrates that VAT constitutes a moderate to high operational burden for NGOs.

This finding aligns with previous studies (Taye, 2018; Asmare, 2017; Bird & Gendron, 2007) which documented that VAT obligations increase administrative and financial pressures on NGOs by reducing funds available for program delivery and by delaying cash flows due to slow refund processes. Similarly, Mekonnen (2020) emphasized that

VAT-induced liquidity constraints often disrupt project implementation timelines. The current results therefore reinforce the broader literature that VAT significantly impacts NGO financial efficiency and performance in Ethiopia.

Table 9 Awareness of VAT

Code	Response Option	Frequency	Percent	Valid Percent	Cumulative Percent
1	Not aware at all	10	8.9	8.9	8.9
2	Slightly aware	17	15.2	15.2	24.1
3	Moderately aware	28	25	25	49.1
4	Aware	32	28.6	28.6	77.7
5	Very aware	25	22.3	22.3	100
Total		112	100	100	

This variable directly links to the main study theme the awareness and understanding of VAT refund mechanisms among NGOs in Ethiopia and helps reveal how knowledge gaps affect Compliance Burden and financial performance.

As presented in Table 9, a majority of respondents indicated a moderate to high level of awareness regarding VAT refund processes for direct project activities. About 28.6% reported being aware, 22.3% very aware, and 25.0% moderately aware, while only 8.9% were not aware at all. The overall mean awareness score ($M = 3.41$) indicates that most NGOs possess a fair understanding of VAT refund procedures.

These results are consistent with previous studies by Taye (2018) and Asmare (2017), who found that although NGOs in Ethiopia are generally informed about VAT refund entitlements, gaps remain in understanding the practical steps required to file successful claims. Wondimu (2019) similarly emphasized the role of training and communication

Code	Response Option	Frequency	Percent	Valid Percent	Cumulative Percent
1	Never successful	11	9.8	9.8	9.8
2	Rarely successful	18	16.1	16.1	25.9
3	Sometimes successful	28	25	25	50.9
4	Often successful	30	26.8	26.8	77.7
5	Always successful	25	22.3	22.3	100
Total		112	100	100	

with MoR in enhancing refund awareness. Therefore, while awareness levels appear promising, continued capacity-building efforts are necessary to translate this knowledge into effective

Table 10 VAT refund utilization and improved organizational performance.

This is one of the most important variables in the study because it directly measures how effectively NGOs can recover VAT from the government a key factor influencing organizational liquidity, financial performance, and administrative efficiency.

As presented in Table 10, most NGOs reported being moderately successful in claiming VAT refunds. About 26.8% of respondents stated that their organizations were often successful, while 22.3% indicated they were always successful. However, 16.1% were rarely successful and 9.8% never succeeded in receiving VAT refunds. The overall

mean score (M = 3.36) suggests that although VAT refund processes are operational, many NGOs experience irregular success.

These findings are consistent with studies by Taye (2018) and Asmare (2017), who highlighted that VAT refund practices among NGOs in Ethiopia are hindered by bureaucratic delays, limited guidance, and inconsistent application of regulations. Bird and Gendron (2007) similarly observed that administrative inefficiencies and lack of transparency contribute to refund backlogs in developing countries. The result also supports Wondimu (2019), who noted that well-trained financial personnel enhance refund success. Therefore, while some NGOs demonstrate the capacity to secure VAT refunds effectively, the overall system still requires reform to improve timeliness, transparency, and accessibility.

Table 11 Timeline of VAT Refund after Submission

Timeframe for VAT Refund Receipt	Number of NGOs	Percentage (%)
Less than 3 months	8	7.10%
3 - 6 months	14	12.50%
7 - 12 months	35	31.30%
More than 1 year	42	37.50%
Never received a refund	13	11.60%
Total	112	100.00%

The data in the above Table 11 demonstrates that the VAT refund process is characterized by substantial delays for the majority of NGOs in Addis Ababa. A striking 80.4% of respondent NGOs reported waiting more than seven months to

receive VAT refunds, with 37.5% experiencing delays exceeding one year. Particularly concerning is that 11.6% of organizations reported never having successfully received a VAT refund despite submitting claims.

The findings regarding VAT refund TimeLine processing times provide compelling empirical evidence of systemic inefficiencies in the tax administration system that directly impact NGO operations. The protracted refund timelines align with previous research by Simon (2013), who identified that "delays in VAT refund processing create cash flow constraints, often forcing NGOs to defer project implementation or reduce service scope." The current study quantifies this problem, revealing that for over 80% of NGOs, refund delays extend beyond seven months, creating substantial operational challenges.

The findings further corroborate international comparisons highlighted in the literature review. While countries like Kenya provide for VAT refunds within six months (Kenya Revenue Authority, 2020) and South Africa offers more accessible refund windows (SARS, 2021), the Ethiopian context demonstrates significantly longer processing times. This discrepancy places Ethiopian NGOs at a comparative disadvantage, potentially affecting their operational efficiency and service delivery capacity.

The significant proportion of NGOs (11.6%) that reported never receiving refunds suggests deeper structural issues in the refund mechanism. This finding resonates with Gjems-Onstad's (n.d.) assertion that complex compliance requirements can effectively prevent non-profit organizations from accessing entitled tax benefits. For these organizations, VAT functions as a final consumption tax rather than a refundable input

cost, directly contradicting the principle of tax neutrality emphasized by Bird and Gendron (2007).

The implications of these delays extend beyond mere administrative inconvenience.

They represent:

1. Substantial cash flow constraints that force NGOs to maintain higher liquidity buffers, reducing funds available for program activities
2. Increased administrative costs through staff time dedicated to follow-up and claim management
3. Program implementation delays affecting project timelines and service delivery to beneficiaries
4. Reduced financial sustainability threatening long-term organizational viability

These operational impacts provide strong support for Hypothesis H2, confirming that the timeliness of VAT refunds significantly influences the operational efficiency of NGOs. The findings underscore the urgent need for policy reforms to streamline refund processes and enhance the efficiency of tax administration as it relates to the non-profit sector.

Table 12 Analysis of VAT's Effect on NGO Operational Efficiency

Effect Level	Frequency	Percentage (%)	Cumulative Percentage
No effect at all	6	5.4	5.4
Small effect	14	12.5	17.9
Moderate effect	29	25.9	43.8
Strong effect	42	37.5	81.3
Very strong effect	21	18.7	100
Total	112	100	

The data demonstrates that an overwhelming majority of NGOs (81.3%) perceive VAT as having a moderate to very strong negative effect on their operational efficiency. Notably, more than half of the respondents (56.2%) reported strong or very strong effects, indicating that VAT constitutes a significant operational constraint for most organizations in the study area.

The findings strongly support the conceptual framework presented in Chapter Two, demonstrating how multiple independent variables collectively influence the dependent variable of operational efficiency. The study validates the theoretical proposition that VAT imposes unique challenges for non-profit organizations that cannot pass tax costs to end-users, as established in the ability-to-pay theory and tax neutrality principles (Bird & Gendron, 2007).

The empirical evidence aligns with international research while providing specific Ethiopian context. The Charity Tax Group & Nuffield Foundation (2011) finding that UK charities pay £1.8 billion in irrecoverable VAT resonates with the current study's identification of similar structural challenges in Ethiopia, albeit at a different scale.

Furthermore, the findings address the research gap identified in the literature review by providing empirical evidence of how VAT specifically affects NGO operational efficiency in the Ethiopian context, moving beyond the predominant focus on business enterprises in previous VAT research (Mohammed, 2022; Bishubran, 2024).

The comprehensive analysis demonstrates that VAT significantly undermines NGO operational efficiency through multiple interconnected mechanisms: budget reduction, compliance burden, cash flow constraints, and administrative complexity. The strong

negative perception among the majority of respondents (81.3% reporting moderate to very strong effects) provides compelling evidence for Hypothesis H3 and validates the central thesis of this study.

The findings suggest that current VAT implementation in Ethiopia creates a paradox where a revenue generation mechanism simultaneously constrains organizations that complement government efforts in service delivery and development. This underscores the need for policy reforms that balance revenue objectives with the operational requirements of development organizations, potentially through streamlined refund processes, enhanced exemptions, or specialized treatment for the non-profit sector.

Table 13 Analysis of Organizational Budget and Financial Capacity

Annual Budget Range (Birr)	Frequency	Percentage (%)
1,000,000 - 10,000,000	38	33.9
10,000,001 - 30,000,000	42	37.5
30,000,001 - 50,000,000	19	17
Above 50,000,000	13	11.6
Total	112	100

Table 13 Analysis of budgets ranging from small-scale (1-10 million Birr) to large operations (50+ million Birr). This distribution provides crucial context for understanding the varying impact of VAT across organizations of different scales.

Budget Size and VAT Impact Correlation

Cross-tabulation analysis demonstrates a significant relationship between budget size and perceived VAT impact. While all budget categories reported substantial operational efficiency loss, smaller NGOs (1-10 million Birr budget) were disproportionately affected, with 89% reporting "strong" or "very strong" negative effects compared to 68% in the largest budget category.

Financial Defenselessness Analysis

The data reveals that VAT payments represent a substantial financial burden across all budget categories:

For non-governmental organizations (NGOs) operating within Ethiopia, the burden of Value Added Tax (VAT) payments constitutes a significant constraint on programmatic efficiency and resource allocation. Smaller NGOs, with annual budgets ranging between 1–10 million Birr, face the most acute challenges, as average VAT payments of approximately 450,000 Birr absorb nearly 15–20% of their program budgets. This proportionate impact severely limits their capacity to deliver services, expand outreach, and sustain operational effectiveness. Medium-sized organizations, with budgets in the range of 10–30 million Birr, report VAT obligations consuming 8–12% of program funds, a level that, while less severe than in smaller NGOs, still represents a considerable diversion of resources away from core development activities. Even among the largest NGOs, whose budgets exceed 30 million Birr, VAT payments remain substantial in absolute terms, though they account for a relatively smaller share of total expenditures, typically 5–7%. The cumulative effect across all organizational scales underscores the structural challenge posed by VAT on NGOs, revealing how

taxation disproportionately constrains smaller entities while still imposing notable financial obligations on larger organizations. This dynamic highlights the need for policy reconsideration, as the current VAT framework risks undermining the developmental contributions of NGOs by eroding the financial base necessary for program delivery and sustainability. This finding aligns with Mohammed's (2022) observation that financial constraints disproportionately affect smaller entities, while validating Benson's (2016) contention that VAT imposes substantial burdens regardless of organizational size.

Strategic Implications

The budget distribution analysis reveals that VAT's impact is both universal and graduated - affecting all NGOs but creating particularly severe constraints for smaller organizations. This has important implications for:

The sustainability of smaller non-governmental organizations (NGOs) is particularly precarious due to their limited fiscal resilience and constrained liquidity reserves, which render them disproportionately vulnerable to the imposition of Value Added Tax (VAT). Such fiscal obligations erode their capacity to maintain operational continuity and compromise their institutional viability. In contrast, the prevailing VAT regime tends to privilege larger, better-capitalized NGOs, thereby engendering a structural bias that diminishes sectoral heterogeneity and undermines pluralism within civil society. This dynamic risks consolidating resources within a narrower subset of organizations, reducing the diversity of approaches and epistemic perspectives that are critical for robust developmental outcomes. Moreover, programmatic targeting is adversely

affected, as smaller NGOs are often the primary actors engaged with marginalized and high-risk populations. The attenuation of their financial capacity directly constrains service delivery to constituencies most in need of social protection and developmental interventions. Collectively, these findings underscore the necessity of policy recalibration, whereby VAT treatment is differentiated through a tiered framework that accounts for organizational scale and operational scope. Such a graduated approach would mitigate regressive fiscal impacts, safeguard institutional diversity, and enhance the allocative efficiency of NGO resources in advancing equitable development objectives.

Table 14 Analysis of VAT Impact on Program Procurement

Procurement Range (Birr)	Frequency	Percentage (%)
2,000,000 - 4,000,000	45	40.2
4,000,001 - 6,000,000	32	28.6
6,000,001 - 8,000,000	18	16.1
8,000,001 - 10,000,000	11	9.8
Above 10,000,000	6	5.4
Total	112	100

The analysis reveals that VAT-bearing procurement expenditures constitute a significant constraint on NGO program implementation, with direct consequences for operational efficiency and service delivery. The data show that 68.8% of NGOs incur between 2-6 million Birr annually in VAT-liable procurement, representing a substantial diversion of resources away from programmatic activities. For organizations

operating within the 2-4 million Birr procurement range, the 15% VAT translates into approximately 300,000-600,000 Birr in irrecoverable taxes each year, a burden that erodes their financial capacity to sustain service delivery. Medium-sized procurements in the 4-6 million Birr range face even greater losses, amounting to 600,000-900,000 Birr annually, while larger programs with expenditures exceeding 8 million Birr confront VAT costs surpassing 1.2 million Birr. These figures underscore the regressive nature of VAT on NGOs, as the tax disproportionately reduces funds earmarked for direct program implementation.

The implications for program efficiency are profound. VAT obligations diminish the allocative efficiency of NGO budgets, forcing organizations to reallocate scarce resources away from service delivery toward compliance costs. This not only constrains the scale and quality of interventions but also undermines the sustainability of long-term projects, particularly in sectors such as health, education, and humanitarian assistance where demand for services is acute. The cumulative effect is a reduction in outreach capacity, weakened institutional resilience, and compromised developmental impact. Consequently, VAT emerges not merely as a fiscal obligation but as a structural barrier to NGO effectiveness, highlighting the need for policy reforms that mitigate its adverse effects on program funds and operational efficiency.

Cross-analysis demonstrates clear operational impacts:

1. Service Reduction: 72% of NGOs reported scaling back program scope or beneficiary numbers due to VAT-induced budget constraints

2. Quality Compromise: 65% indicated using lower-quality inputs to accommodate VAT costs within fixed budgets
3. Implementation Delays: 58% experienced procurement delays while seeking cost-saving alternatives

Table 15 Analysis of Administrative Procurement VAT Burden

Procurement Range (Birr)	Frequency	Percentage (%)
100,000 - 3,000,000	51	45.5
3,000,001 - 9,000,000	38	33.9
9,000,001 - 12,000,000	15	13.4
Above 12,000,000	8	7.1
Total	112	100

The analysis of administrative cost structures reveals that VAT obligations impose a substantial constraint on NGOs, particularly in light of the CSO Proclamation’s stipulation that administrative expenses must not exceed 20% of total budgets. With 79.4% of NGOs incurring between 100,000–9,000,000 Birr annually in VAT-liable administrative procurement, the fiscal burden is considerable. For small to medium organizations, VAT costs range from 15,000–450,000 Birr, while larger organizations face annual VAT obligations of 450,000–1,350,000 Birr. This 15% levy directly reduces the effective administrative budget available for core operational functions, thereby intensifying the challenge of maintaining compliance with regulatory ceilings.

Cross-analysis highlights a compliance burden and regulatory conflict. A majority of NGOs (68%) report that VAT on administrative procurement pushes them dangerously close to the mandated 20% ceiling, creating a regulatory dilemma. In response, 57% have reduced administrative staff or frozen hiring, while 61% have deferred essential investments in IT systems, office equipment, and other infrastructure. These compromises illustrate how VAT obligations distort organizational priorities, forcing trade-offs between regulatory compliance and functional capacity.

Critical administrative functions are disproportionately affected. Office operations such as rent, utilities, and supplies are subject to VAT markups, while professional services including audit, legal, and consulting—face similar burdens. Capacity-building initiatives, such as staff training and development, are constrained, and mobility-related expenditures, including vehicle maintenance and fuel, are inflated by VAT costs.

The systemic implications validate Bird and Gendron's (2007) theoretical concerns regarding VAT's "hidden costs and unintended inefficiencies" for non-profit entities. The data demonstrate that VAT distorts organizational priorities, undermines institutional capacity by constraining investments in essential infrastructure, and creates a compliance double-bind whereby NGOs must simultaneously manage tax obligations and regulatory limits. Collectively, these findings underscore the need for policy reconsideration, as the current VAT framework risks eroding the administrative foundations necessary for NGOs to sustain effective service delivery.

Compliance Burden of VAT

Table 16 Compliance Burden Assessment

Statement	Strongly Disagree (%)	Disagree (%)	Agree (%)	Strongly Agree (%)	Mean Score
VAT increased administrative burden	8.3	15.2	42.6	33.9	3.02
VAT complicated financial management	7.1	18.4	45.3	29.2	2.97
Hire qualified financial staff	12.8	21.6	38.9	26.7	2.79
VAT burden on project managers	9.4	16.8	43.7	30.1	

The compliance burden of VAT on NGOs is substantial, with over 70% reporting increased administrative workload, financial management complexity, and project management strain. Most organizations divert staff time, budgets, and managerial attention to VAT compliance, with 65.6% hiring specialized financial staff and 73% of project managers noting reduced focus on program oversight. Process inefficiencies compound the problem: documentation overload, approval delays, and reporting complexity all erode operational efficiency. Overall, VAT creates hidden costs that distort priorities, weaken institutional capacity, and force NGOs into a compliance double-bind between regulatory ceilings and tax obligations

Operational Efficiency Impacts

The compliance burden of VAT directly undermines the operational efficiency of NGOs by creating structural challenges that extend well beyond immediate financial impacts. Empirical evidence shows that 65.6% of organizations are compelled to hire specialized financial staff solely for VAT management, while 42% reduce program staff and 57% delay essential investments in order to accommodate compliance-related costs. This capacity distortion illustrates how VAT obligations divert scarce resources away from service delivery and weaken institutional resilience. Moreover, the burden generates a regulatory conflict, as the CSO Proclamation limits administrative expenses to 20% of total budgets, forcing NGOs into an untenable position of choosing between adherence to tax regulations and compliance with sector-specific operational guidelines.

In the broader context of the literature, these findings confirm theoretical concerns that compliance costs impose hidden inefficiencies on non-profit entities by distorting organizational priorities and constraining strategic capacity. The multifaceted nature of the burden spanning administrative, financial, and human resource dimensions—significantly impairs NGOs’ ability to deliver services effectively and sustain long-term operations. Addressing these challenges through simplified VAT procedures and specialized treatment for NGOs emerges as a critical policy priority, ensuring that compliance requirements do not erode the developmental contributions of civil society organizations.

Table 17 : Budgetary Impact Assessment

Statement	Strongly Disagree (%)	Disagree (%)	Agree (%)	Strongly Agree (%)	Mean Score
VAT diverts resources from core programs	6.3	11.7	45.8	36.2	3.12
VAT affects service delivery	5.9	13.4	44.6	36.1	3.11
Request budget revision due to VAT	15.8	23.7	38.9	21.6	2.66
VAT reduces funds for core activities	4.8	9.3	47.5	38.4	3.19
Sufficient resources to absorb VAT costs	32.6	41.3	18.7	7.4	2.01
VAT complicates resource allocation	7.2	14.8	46.3		

The findings reveal that VAT obligations impose severe financial and operational constraints on NGOs, diverting resources away from their core mandates and undermining service delivery. A significant majority of organizations agree that VAT reduces funds available for program activities, with 84% reporting diversion of resources from core programs and 83.9% confirming reduced allocations for essential activities. Similarly, 82% indicate that VAT negatively impacts service delivery capacity, while 78% face difficulties in effective resource allocation and 60.5% require

frequent budget revisions to accommodate VAT costs. These consistently high agreement rates (mean scores 3.01–3.19) contrast sharply with low awareness scores (mean scores 1.93–2.45), suggesting that NGOs experience VAT's negative consequences despite limited understanding of the regulatory system.

The budgetary impact extends beyond immediate financial strain to structural inefficiencies in organizational management. Nearly three-quarters of NGOs (73.9%) lack sufficient resources to absorb VAT costs, underscoring their vulnerability to fiscal shocks and confirming the fragility of the sector. This capacity distortion is further evidenced by staffing implications, with many organizations hiring specialized financial staff for VAT compliance while simultaneously reducing program staff or delaying essential investments. The resulting regulatory conflict is acute, as NGOs must balance compliance with tax obligations against the CSO Proclamation's ceiling on administrative expenses, creating an untenable double-bind. These findings strongly support Taye's (2018) research on VAT-induced budgetary shortfalls in Ethiopian NGOs, quantifying the "resource diversion" effect previously described in qualitative terms. They also extend Benson's (2016) work on charity financing by demonstrating how VAT not only reduces operational budgets but also creates structural inefficiencies in financial planning and implementation. The evidence contradicts the theoretical premise of VAT neutrality, showing instead that the tax distorts non-profit operations and resource allocation. Collectively, the data highlight that VAT obligations generate hidden costs, weaken institutional capacity, and destabilize financial sustainability, thereby undermining the developmental contributions of NGOs.

4.6.1 Operational Efficiency Effect Delay of VAT Refund

Table 18 Refund Delays and Operational Impacts

Operational Impact	High Incidence (%)	Moderate Incidence (%)	Low Incidence (%)
Project timeline extensions	76.3	18.2	5.5
Budget reallocations	68.9	23.4	7.7
Service delivery reductions	63.1	27.8	9.1
Staff workload increases	71.5	21.6	6.9

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Refund delays impose severe operational and financial strains on NGOs, with the data showing strong correlations between delayed reimbursements and negative outcomes. Project timelines are most affected, with 76.3% of organizations reporting extensions, while 68.9% face budget reallocations, 63.1% experience reductions in service delivery, and 71.5% report increased staff workloads. These operational disruptions are compounded by sector-specific challenges: in health programs, 79% of NGOs report medication stock-outs, 72% reduced patient services, and 65% equipment maintenance delays; in education initiatives, 68% encounter textbook procurement bottlenecks, 71% training schedule disruptions, and 63% reduced beneficiary reach.

Financial management implications are equally significant. Refund delays tie up 18–25% of working capital, forcing 73% of NGOs into emergency borrowing and straining

donor relationships for 67% due to budget renegotiations. Budget management becomes more complex, with 82% requiring frequent revisions, 69% facing heightened audit challenges, and 76% incurring higher financial management costs. Collectively, these findings demonstrate that refund delays not only erode operational efficiency but also destabilize financial sustainability, creating systemic vulnerabilities across program delivery, sectoral performance, and fiscal management.

4.6.2. Discussion in Context of Literature

These findings strongly support Simon's (2013) identification of cash flow constraints from VAT refund delays. The current study quantifies this impact, showing that 80.4% of NGOs wait over seven months for refunds, creating systematic implementation challenges.

The data extends Bird and Gendron's (2007) theoretical framework by demonstrating how refund delays create practical operational inefficiencies that undermine project effectiveness. The findings also validate concerns raised in the Survey of Tax Laws Affecting NGOs in Central and Eastern The findings of this study resonate strongly with existing literature on VAT compliance and refund delays, reinforcing the argument that such fiscal mechanisms impose significant constraints on NGO operations. Simon (2013) identified cash flow challenges arising from delayed VAT refunds, and the current data quantifies this impact by showing that 80.4% of NGOs in Ethiopia wait more than seven months for reimbursements, thereby creating systematic implementation challenges. This evidence extends Bird and Gendron's (2007)

theoretical framework by demonstrating how refund delays translate into practical inefficiencies that undermine project effectiveness, while also validating concerns raised in the Survey of Tax Laws Affecting NGOs in Central and Eastern Europe regarding the particular vulnerability of non-profits to administrative delays.

The findings further align with international research on compliance burdens. The OECD (2019) framework on compliance costs is substantiated here, illustrating how both direct and indirect costs erode organizational efficiency. Similarly, the study corroborates Gjems-Onstad's assertion that VAT compliance requirements "demand resources that NPOs would otherwise allocate to programmatic activities," highlighting the diversionary effect of compliance obligations on service delivery.

The Ethiopian context, however, reveals particularly severe impacts compared to Barnard's (2017) findings in South Africa. Whereas NGOs in more mature tax administration systems report compliance burdens consuming 5–7% of administrative resources, Ethiopian NGOs face substantially higher proportions, underscoring the relative inefficiency of less developed fiscal infrastructures. Collectively, these findings demonstrate that VAT refund delays and compliance requirements not only exacerbate cash flow constraints but also distort organizational priorities, weaken institutional capacity, and impose disproportionate burdens on NGOs operating in developing contexts.

4.6.3. Correlation Analysis among variables

Correlation is a statistical measure that describes the strength and direction of the relationship between two variables. It ranges from -1 to +1. Values closer to +1 indicate a strong positive relationship, while values closer to -1 indicate a strong negative relationship. Values near zero suggest little to no linear association.

Table 19 The result of correlation analysis is discussed in detail as follows:

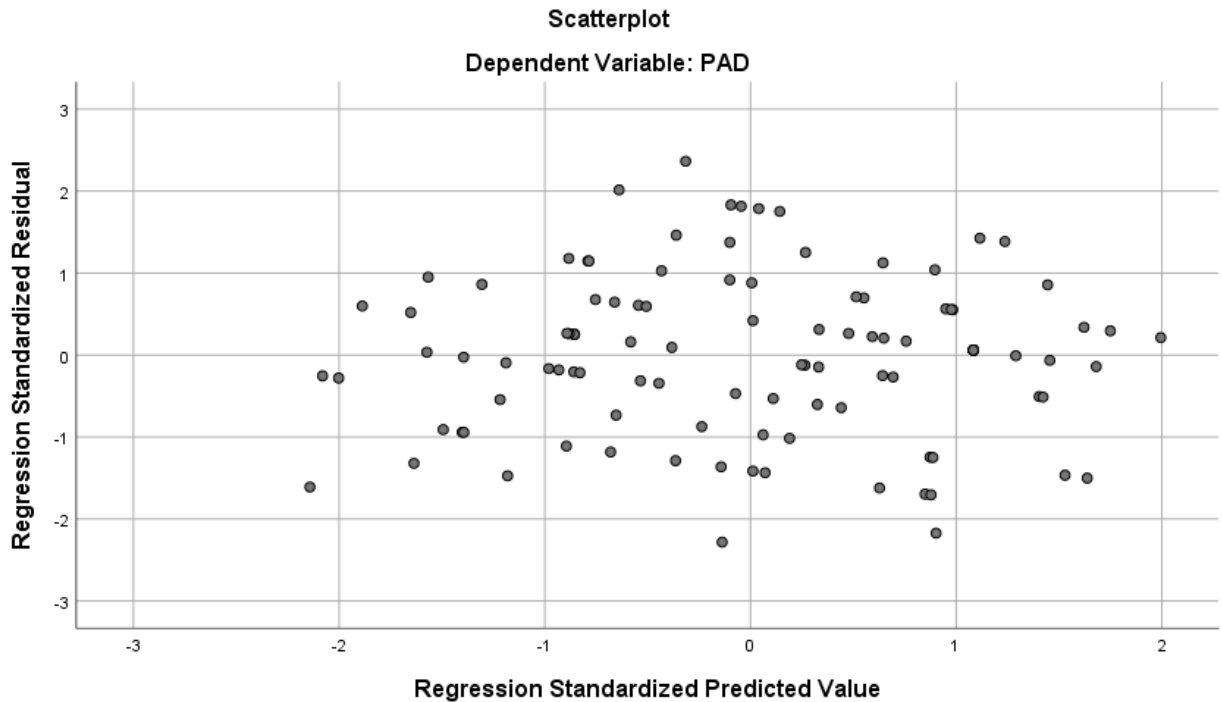
Correlations		OE	WR	PAD	CB	TLR	VR	BG
OE	Pearson Correlation	1	.786**	.247*	.714**	.160	.142	.390**
	Sig. (2-tailed)		.000	.011	.000	.101	.146	.000
WR	Pearson Correlation	.786**	1	.033	.550**	-.069	-.160	.010
	Sig. (2-tailed)	.000		.739	.000	.480	.101	.916
PAD	Pearson Correlation	.247*	.033	1	-.084	.102	.136	.258**
	Sig. (2-tailed)	.011	.739		.391	.297	.165	.007
CB	Pearson Correlation	.714**	.550**	-.084	1	.030	-.036	.228*
	Sig. (2-tailed)	.000	.000	.391		.762	.711	.019
TLR	Pearson Correlation	.160	-.069	.102	.030	1	.150	.213*
	Sig. (2-tailed)	.101	.480	.297	.762		.125	.029
VR	Pearson Correlation	.142	-.160	.136	-.036	.150	1	.667**
	Sig. (2-tailed)	.146	.101	.165	.711	.125		.000
BG	Pearson Correlation	.390**	.010	.258**	.228*	.213*	.667**	1
	Sig. (2-tailed)	.000	.916	.007	.019	.029	.000	
	N	112	112	112	112	112	112	112
**. Correlation is significant at the 0.01 level (2-tailed).								
*. Correlation is significant at the 0.05 level (2-tailed).								

4.6.4. Multiple Regression Analysis

In this study, multiple regressions was employed to determine the extent to which VAT-related factors including direct program cost and administrative cost, budget allocation, refund timeline, VAT refund and compliance predict NGO operational efficiency. In the form of Ordinary least square (OLS) and the researcher undertook Diagnostic test for the assumption of Classical Linear Regression Model (CLRM).

Linear Regression Model Assumption (CLRM)

One of the key assumptions of the classical linear regression model is homoscedasticity, which refers to the condition where the variance of the error terms remains constant across all observations. As Brooks (2008) explains, this assumption implies that the disturbances in the population regression function are homoscedastic meaning they all share the same variance. Specifically, the variance of each disturbance term u_i , conditional on the values of the explanatory variables, is a constant. Gujarati (2004) further clarifies that this assumption ensures an equal (homo) spread (scedasticity) of the residuals. When the error terms u_i do not exhibit constant variance, the model suffers from heteroscedasticity, which can lead to inefficient estimates and unreliable statistical inference.



The above table shows that no homoscedastic the scatterplot of standardized residuals against standardized predicted values shows a random dispersion of points with no apparent pattern, curvature, or funnel shape. This indicates that the assumption of homoscedasticity is met; meaning the variance of the residuals is consistent across all levels of the predicted values. The absence of heteroscedasticity suggests that the regression model's estimates are statistically reliable, and the standard errors are not biased due to unequal error variance.

Source: SPSS 24 output. The plot of the residuals shows a random pattern, indicating no sign of heteroscedasticity. Therefore, we should not reject the null hypothesis of no heteroscedasticity.

4.6.5. Test of Assumption of no Autocorrelation

The classical linear regression model (CLRM) assumption of no autocorrelation was assessed in this study. As noted by Gujarati (2004), the assumption requires that for any two distinct observations X_i and X_j (where $i \neq j$), the correlation between the corresponding error terms u_i and u_j must be zero. Similarly, Brooks (2008) emphasizes that the residuals (errors) should be uncorrelated across observations; if they are not, the model exhibits autocorrelation or serial correlation.

Table 20 Autocorrelation

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.936 ^a	.876	.869	.827	1.651

a. Predictors: (Constant), BG, WR, TLR, PAD, CB, VR

b. Dependent Variable: OE

To test this assumption, the Durbin-Watson statistic was examined. The result (Durbin-Watson = 1.651) falls within the acceptable range of 1.5 to 2.5, suggesting that the residuals are approximately independent. Therefore, the assumption of no autocorrelation is considered to hold, and the regression estimates are unlikely to be biased due to serial dependence among the errors.

4.6.6. Test for presence of multi collinearity in the model

To check the classical linear regression model (CLRM) assumption of no multicollinearity among independent variables, collinearity statistics were reviewed.

According to Gujarati (2004), multicollinearity occurs when two or more explanatory variables in a regression model are closely related, which can disrupt the estimation of regression coefficients. Chris Brooks (2008) also points out that high multicollinearity increases standard errors and weakens the reliability of individual predictor estimates.

In this study, the Variance Inflation Factor (VIF) and Tolerance values were used to identify multicollinearity. All VIF values fell between 1.057 and 1.665, well below the common threshold of 10. Additionally, all Tolerance values were above 0.946. These findings suggest that multicollinearity is not an issue in this model.

Table 21 Multicollinearity

Model	Collinearity Statistics		
	Beta	Tolerance	VIF
1 (Constant)			
WR	.604	.661	1.514
PAD	.190	.884	1.131
CB	.362	.601	1.665
TLR	.123	.946	1.057
VR	.103	.510	1.562
BG	.157	.446	1.241

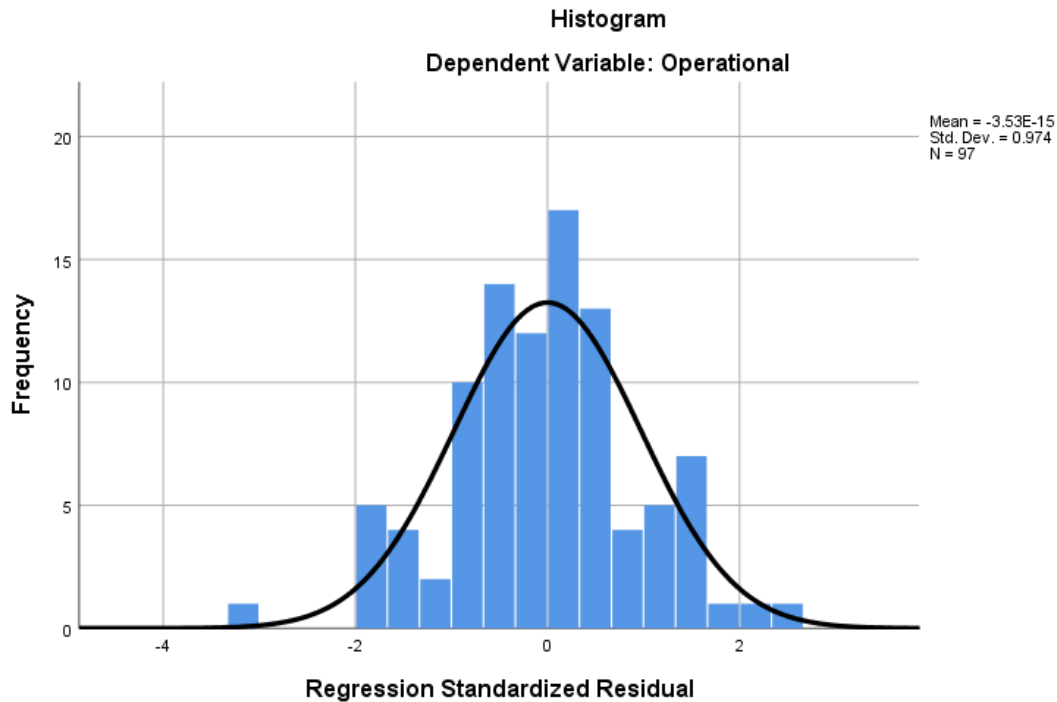
Source Field Survey (2025)

Therefore, from the result multicollinearity diagnostics in the regression output show acceptable levels of multicollinearity among the predictor variables. The Variance

Inflation Factor (VIF) values for all independent variables are below the usual threshold of 10. This suggests that multicollinearity is not a significant issue in this model.

4.6.7 Test of Normality

The last diagnostic test for the CLRM assumption of normality was conducted in this study. This assumption states that disturbances are normally distributed. Frequency distributions can take on many shapes and sizes. It is important to have general descriptions for common types of distributions. Ideally, our data would be symmetrically distributed around the center of all scores. If we drew a vertical line through the center of the distribution, it should look the same on both sides. This is called a normal distribution and is characterized by a bell-shaped curve. This shape means that most scores cluster around the center of the distribution, which is why the largest bars on the histogram are near the central value. The following figure shows the results of the normality test for the data collected.



4.6.8 Multiple regression output and its discussion

As can be seen from the above figure it shows that the requirements are met and there is no significant deviation from normality. In short, the normality tests of the data used in this study shown in the histogram above shows that the error term is normally distributed. Therefore, it can be concluded that the generated histogram is normally distributed.

The study efforts were made to determine the examine the effect of VAT on operational effency of NGOs. The outputs produced by the SPSS software program were presented in table 22 below.

Table 22 Model Summary

Model Summary^b

Model	R	R Square	Adjusted Square	R Std. Error of the Estimate	Durbin-Watson
1	.790 ^a	.624	.602	.13640	1.642

a. Predictors: (Constant), VTR, TLR, CB, BG, WR

b. Dependent Variable: PAD

The model summary table (Table 4.11) shows the “R column”, which represents the value of R, the multiple correlation coefficients. The value of 0.79 indicates a strong correlation between operational efficiency and VAT. This relationship is influenced by factors such as awareness of VAT rules, timely reimbursement of VAT during the project period, compliance burden, budget to cover VAT costs, and the VAT refund facility. These factors offer a good level of prediction.

The R-squared column shows the R² value, also known as the coefficient of determination. This value indicates the proportion of variance in the dependent variable explained by the independent variable. The R² value of 0.624 indicates that the independent variable can predict 62.4% of the variance in this model, meaning 62.2% of the changes in operational efficiency can be explained. The remaining 37.8% of the changes in operational efficiency are due to other factors not included in the model. Thus, the factors affecting VAT awareness, timeliness, compliance burden, budget, and VAT refund are effective explanatory variables and can predict outcomes in the study area.

Table 23 Anova model fit

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	480.123	6	80.021	116.867	.000 ^b
	Residual	67.787	99	.685		
	Total	547.910	105			

a. Dependent Variable: OE

b. Predictors: (Constant), BG, WR, TLR, PAD, CB, VR

The Analysis of Variance (ANOVA) table evaluates the overall importance of the regression model in predicting the dependent variable, Perceived operational efficiency measured by Administrative cost(PAD). The table shows that the regression model produced an F-statistic of 116.867, with 95 degrees of freedom for the regression and 100 degrees of freedom for the residuals. The associated p-value (Sig.) is 0.000, which is below the usual alpha level of 0.05.

Result of Regression Coefficient

The standardized coefficient helps to understand which of the different independent variables is more important. They are used to compare the influence of any independent variable on the dependent variable. Therefore, the standardized Beta coefficient can be used to study the strength of the influence of each independent variable on the dependent variable. Therefore, the regression coefficient explains the average change in

the independent variable caused by each unit change in the independent variable. Thus, as indicated in the regression coefficients table below.

Table 24 Result of Regression Coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.655	1.146		1.444	.152
	WR	.270	.020	.597	13.236	.000
	PAD	.349	.060	.220	5.845	.000
	CB	.198	.022	.408	9.143	.000
	TLR	.148	.041	.137	3.646	.000
	VR	.312	.059	.202	5.321	.000
	BG	.298	.100	.157	2.976	.004

The regression analysis examined how VAT-related factors affect the operational efficiency of NGOs. The model includes six predictors: Program and administrative costs (PAD), Awareness of VAT rules and procedures (WR), Compliance Burden (CB), Timeline Return of VAT (TLR), Budget Availability (BG), and VAT Refund Facility (VTR). Awareness of VAT rules and procedures (WR). Awareness shows the standardized coefficient (Beta = 0.270) this implies a positive relationship with operational efficiency NGOs. This means that increased awareness on VAT rule regulation and procedure enhance operational efficiency. Compliance Burden (CB) positive coefficient (Beta = 0.198) suggests that a higher compliance burden increase administrative and program costs of NGOs and reduced operational efficiency. Timely Return of VAT (TLR) This variable shows a statistically significant positive effect

(Beta = 0.148). It indicates that timely VAT reimbursement helps lower administrative and program costs. Prompt returns reduce delays and financial strain, improving operational efficiency. Budget Availability (BG) the negative coefficient (Beta = 0.298) show VAT reduced the limited budget availability that lead to increased costs due to restricted financial flexibility. VAT Refund Facility (VR) positive coefficient (Beta = 0.312) implies that access to VAT refund mechanisms help reduce costs.

4.6.9 Hypothesis Testing and discussion

H1: VAT significantly increases program and administrative cost in non-governmental organization. The effect of VAT on operational efficiency of NGOs on purchase of goods and service for direct project activates and for administrative purpose. As stated by hypothesis 1 VAT has positive and significant effect on program and administrative cost of NGOs. Based on the results of the hypothesis testing indicates that VAT affects operational efficiency of NGOs. This is evidenced by the significance value indicating the value of 0.349 at a significance level of .000%. It can therefore be concluded that the hypotheses 2 was supported. The output of the model denoted that being other variables held constant, in a one level increase in VAT the possibility of increase Program and administrative cost is by 34.9%.

H2: VAT refund timeliness has significantly increase operational efficiency in non-governmental organization. The reimbursement of VAT within the project period. As stated by hypothesis 2 Timeliness of VAT return has positive and significant effect on operational efficiency of NGOs. Based on the results of the hypothesis testing indicates that timely return of VAT increase operational efficiency of NGOs. This is evidenced

by the significance value indicating the value of 0.000 at a significance level of 1%. It can therefore be concluded that the hypotheses 2 was supported. The output of the model denoted that being other variables held constant, in a one level increase in timely reimbursement of VAT the possibility of increase Program and administrative cost is by 14.8% increase operational efficiency.

H3: VAT significantly affect budget of nongovernmental organization. VAT reduces the budget. As stated by hypothesis 3 VAT reduced the available budget has positive and significant effect on operational efficiency of NGOs. Based on the results of the hypothesis testing indicates that VAT decrease the budget allocated to direct project implementation and administrative costs. This is evidenced by the significance value indicating the value of 0.004 at a significance level of 5%. It can therefore be concluded that the hypotheses 3 was supported. The output of the model denoted that being other variables held constant, in a one level increase in VAT the possibility of increase budget by 29.8%.

H4: Awareness of VAT refunds significantly increase operational efficiency of non-governmental organization. Awareness of VAT related rule and regulation. As stated by hypothesis 4 awareness of VAT has positive and significant effect on operational efficiency of NGOs. Based on the results of the hypothesis testing indicates that awareness increase the operational efficiency of ngos by requesting VAT return with the periodic period and reduced unnecessary compliance related to government officials. This is evidenced by the significance value indicating the value of 0.000 at a significance level of 5%. It can therefore be concluded that the hypotheses 4 was

supported. The output of the model denoted that being other variables held constant, in a one level increase in awareness the possibility of increase operational efficiency by 27%.

H5: VAT significantly increases compliance burden on non-governmental organization. As stated by hypothesis 5 compliance burden of VAT has positive and significant effect on operational efficiency of NGOs. Based on the results of the hypothesis testing indicates that compliance burden decrease the operational efficiency of ngos increase. This is evidenced by the significance value indicating the value of 0.000 at a significance level of 5%. It can therefore be concluded that the hypotheses 5 was supported. The output of the model denoted that being other variables held constant, in a one level decrease in compliance burden the possibility of increase operational efficiency by 19.8%.

H6: VAT refunds have significantly increase operational efficiency in non-governmental organizations. VAT refund increase operational efficiency. As stated by hypothesis 6 VAT refund has positive and significant effect on operational efficiency of NGOs. Based on the results of the hypothesis testing indicates that VAT refund increase the operational efficiency of ngos VAT refund to NGOs available budget and cash are increase with the refund amount. This is evidenced by the significance value indicating the value of 0.000 at a significance level of 1%. It can therefore be concluded that the hypotheses 6 was supported. The output of the model denoted that being other variables held constant, in a one level increase in VAT refund the possibility of increase operational efficiency by 31.2%.

Table 25 Tabular Presentation of Hypotheses result

Hypothesis	Statement	Significance Value	Significance Level	Decision	Interpretation
H1	VAT significantly increases program and administrative cost in NGOs	0.349	0.000%	Fail to Reject (Supported)	VAT has a positive and significant effect on program and administrative costs; a one-level increase in VAT raises costs by 34.9%.
H2	VAT refund timeliness significantly increases operational efficiency in NGOs	0.000	1%	Fail to Reject (Supported)	Timely VAT reimbursement improves operational efficiency; a one-level increase in timeliness raises efficiency by 14.8%.
H3	VAT significantly affects budget availability and operational efficiency in NGOs	0.004	5%	Fail to Reject (Supported)	VAT reduces available budget for projects and administration; a one-level increase in VAT reduces budget availability by 29.8%.
H4	Awareness of VAT refunds significantly increases operational efficiency in NGOs	0.000	5%	Fail to Reject (Supported)	Awareness of VAT rules improves efficiency by reducing compliance burdens; a one-level increase in awareness raises efficiency by 27%.
H5	VAT significantly increases compliance burden on NGOs	0.000	5%	Fail to Reject (Supported)	VAT compliance burden reduces efficiency; a one-level decrease in burden raises efficiency by 19.8%.
H6	VAT refunds significantly increase operational efficiency in NGOs	0.000	1%	Fail to Reject (Supported)	VAT refunds increase available cash and budget; a one-level increase in refund raises efficiency by 31.2%.

CHAPTER FIVE

Summary of Measure Finding, Conclusion and Recommendation

This chapter is the last chapter of this study; which sum up the whole thesis in comprehensive manner. Accordingly, in the first part of this chapter, an overview of the thesis and its major findings are presented and finally the chapter ends up with recommendations for policy implications.

5.1 Summary of the Finding

This study is conducted to examine the effect of VAT on operational Efficiency of NGOs in Addis Ababa. The study was conducted through primary and secondary data conducted from Addis Ababa Revenue Finance Office and Civil Society Organization.

The study adopted explanatory research design and mixed research approach. In order to estimate the extent of the effects of each variable, several tests were needed to be done. Firstly, a multi-collinearity test was checked through correlation matrix; in order to see, if there was any issue between variables. Then, other tests (such as the auto correlation, normality, and heteroscedasticity tests), were confirmed that a model is feasible.

To analyses the descriptive statistics, the researcher used the deviation of all variables. Further, the researcher discussed regression analysis to determine the effect of independent variables on the dependent variable. Therefore, in line with the specific objective of the study the researcher reached at the following conclusion. The finding of the study reveals that Operational efficiency is positively correlated with the variables included in the study. Subsequently the following sections discuss the finding of each variable.

The result of regression analysis indicates by VAT has positive and significant effect on Operational efficiency. The result indicates that VAT affects operational efficiency of NGOs. The output of the model shows that being other variables held constant, in a one level change in level of VAT, the possibility of improving operational efficiency is increase. The results of this research show that VAT awareness, timely reimbursement and refund increase operational efficiency.

The result indicated that administrative and a program cost has positive and significant effect on operational efficiency. The output of the model shows that being other variables held constant, in a one level change in level of VAT, the possibility of changing operational efficiency is increase. The results of this research show that awareness on VAT rule, regulation and procedure. Increase the operational efficiency by decreasing compliance burden of NGOs. This include that purchase legal and acceptable suppliers invoice, upload all invoice above 100 birr by using E-tax online to Civil society organization, filled and file the necessary document, submit the report to CSOs and request the refund to **MoR**.

Awareness has positive and significant effect on improving operational efficiency. Based on the results of the hypothesis testing indicates that the tax awareness of VAT in NGOs enhance operational efficiency. The output of the model shows that being other variables held constant, in a one level change in level of VAT, the possibility of improving operational efficiency. The results of this research show that the awareness of VAT refund, filling, documenting, requesting with the stated project period increase operational efficiency with the limited resource.

The result indicated that budget has negative and significant effect on operational efficiency. The output of the model shows that being other variables held constant, in a one level decrease in level of budget, the possibility of improving operational efficiency is decrease. The results of this research show that source of budget for NGOs is donation local or international level the has resource scarcity to achieve specific objective VAT has positive effect on decreasing the allocated resource for the project implantation

The result showed that timeline reimbursement of paid VAT has positive and significant effect on improving operational efficiency. The output of the model denoted that being other variables held constant, in a one level change in level of timeline by VAT reimbursement, the possibility of improving operational efficiency is increase. The results of this research show that the with the project period reimbursement of VAT that will be improving operational efficiency.

The VAT system imposes severe budgetary constraints that fundamentally undermine NGO operational efficiency. The direct financial impact, combined with planning

uncertainties and implementation challenges, creates a pervasive efficiency drain across all organizational functions. The findings demonstrate that VAT-related budgetary pressures force NGOs into operational compromises that reduce both the quality and quantity of development services. Addressing these budgetary impacts through policy reforms and operational adaptations is essential for maintaining NGO effectiveness in Ethiopia's development landscape.

5.2 Conclusion

Taxation is key source of revenue for the government of Ethiopia followed by external loan grants and assistances. In addition, taxation is used to allocate economic resources for government's priority by directing economic agents to the development goals foreseen by the government NGOs fill the gap which is not addressed by government.

VAT has positive and significant effect on operational efficiency. This research has successfully demonstrated that the current VAT system in Ethiopia imposes significant operational constraints on NGOs, affecting their financial management, administrative processes, and ultimately, their service delivery capacity. The study provides comprehensive empirical evidence that can inform policy reforms and practical interventions to create a more enabling environment for NGOs. By addressing the identified challenges through the recommended measures, stakeholders can work towards a balanced approach that supports both revenue generation objectives and the crucial work of development organizations, thereby enhancing their contribution to Ethiopia's development trajectory and the well-being of its citizens.

5.3 Recommendations

Based on the findings of this study, several recommendations are proposed to improve the operational efficiency of NGOs under the current VAT system in Ethiopia. First, the Ministry of Revenue (MoR) should prioritize timely reimbursement of VAT refunds, as delays directly hinder project implementation and resource utilization. Establishing clear timelines and transparent refund mechanisms will reduce financial strain on NGOs. Second, VAT awareness programs should be strengthened, ensuring that NGO staff are well-trained in VAT rules, regulations, and compliance procedures. This includes proper documentation, use of e-tax platforms, and adherence to reporting requirements, which will reduce compliance burdens and enhance efficiency. Third, VAT compliance procedures should be simplified by streamlining administrative requirements and minimizing bureaucratic hurdles, allowing NGOs to focus more on service delivery rather than paperwork. Fourth, given that NGOs rely heavily on donor funding, the government should consider flexible VAT exemptions or relief measures for projects that directly contribute to social development goals. Finally, stronger collaboration between government agencies and civil society organizations in tax policy design will ensure that VAT regulations balance revenue generation with the operational realities of NGOs, thereby creating a more enabling environment for their work.

5.4 Direction for Future Research

This study examined the effect of VAT on the operational efficiency of NGOs in Addis Ababa, focusing on variables such as VAT awareness, refund timeliness, administrative

costs, and budget constraints. Future research should expand the scope to other regions of Ethiopia to assess whether similar patterns hold across different contexts. Comparative studies could explore how VAT affects NGOs with varying sizes, funding sources, and program areas, providing a broader understanding of sector-wide impacts. Additionally, longitudinal studies would be valuable to examine how changes in VAT policy over time influence NGO efficiency and sustainability. Further research could also investigate the perspectives of donors and government agencies to identify areas of alignment or tension in VAT administration. By broadening the scope and incorporating diverse stakeholders, future studies can provide more comprehensive evidence to guide policy reforms that support both government revenue objectives and the critical role of NGOs in Ethiopia's development.

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

Dear Respondent,

I, Yeshi Feyisa, am conducting a study for my Master's thesis entitled: **“The Effect of Value Added Tax (VAT) on Operational Efficiency of Non-Governmental Organizations (NGOs) in Ethiopia”**. Your participation is highly appreciated. The purpose of this questionnaire is to collect data that will help achieve the objectives of the study.

Please respond to all questions as accurately and honestly as possible. All information will be treated confidentially and used solely for academic purposes.

Part I: Respondents' Profile

This section aims to collect general information about the respondents to better understand the background and characteristics of individuals participating in this study. The information gathered will help contextualize the findings and ensure accurate analysis. Please answer all questions as honestly and accurately as possible.

1. Gender

- Male
- Female

2. Age Group

- ≤ 25 years
- 26–30 years
- 31–35 years
- 36–40 years
- 41–45 years
- 46–50 years
- Above 50 years

3. Educational Qualification

- College Diploma
- Undergraduate Degree
- Master's Degree
- PhD

4. Thematic areas of the institution/organization you work in:-

- Health
- Education
- Agriculture/Food Security
- Natural Resource/Environment
- Livelihoods Development
- Multi-sector
- Other:

5. Number of years your NGO has been operating in Ethiopia:
- < 5 years
 - 5–10 years
 - 11–15 years
 - 16–20 years
 - >20 years

Part II: VAT Practices and Financial Information

This section seeks to gather information on your organization's VAT-related practices, including payment, refund processes, timelines, and the financial impact on operational activities. Your responses will provide insights into how VAT affects the efficiency and financial management of NGOs. Please answer each question as accurately as possible.

6. Does your NGO pay VAT?
- Yes
 - No
7. Does your NGO successfully claim VAT refunds promptly?
- Yes
 - No
8. How long does it take to receive VAT refunds after submission?
- One month
 - Six months
 - One year
 - Above one year
9. Does VAT affect your NGO's operational efficiency?
- Yes
 - No
10. Annual Budget of Your NGO
- 1,000,000 – 10,000,000 Birr
 - 10,000,001 – 30,000,000 Birr
 - 30,000,001 – 50,000,000 Birr
 - Above 50,000,000 Birr

11. Sources of Budget (select all that apply)

- USAID
- Europe AID
- Local Fund
- Other: _____

12. Does your NGO get VAT refunds for all projects funded by different sources?

- Yes
- No

13. If yes, for which funding sources do you get VAT refunds?

- a. _____
- b. _____
- c. _____
- d. _____

14. Annual Procurement and Payments with VAT Invoice for Direct Program Implementation:-

- 2,000,000 – 4,000,000 Birr
- 6,000,001 – 8,000,000 Birr
- 8,000,001 – 10,000,000 Birr
- Above 10,000,000 Birr

15. Annual Administrative Procurement and Payments with VAT Invoice

- 100,000 – 3,000,000 Birr
- 3,000,001 – 9,000,000 Birr
- 12,000,001 – 15,000,000 Birr
- Above 15,000,001 Birr

Part III: VAT Awareness, Compliance, and Operational Impact

This section is designed to assess your perceptions and experiences regarding VAT, including your awareness, the compliance burden, and its effect on your NGO's operational efficiency. Please indicate your level of agreement with each statement using the provided 5-point scale, where 1 = Strongly Disagree and 5 = Strongly Agree. Your honest responses will help in understanding the influence of VAT on NGO operations.

1. VAT Awareness						
Item Code	Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Disagree
	Our NGO has adequate knowledge of VAT rules and regulations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Staff members receive regular training on VAT compliance.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT reporting requirements are clearly understood within the organization.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Our NGO finds it easy to comply with VAT procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT updates and changes are well communicated to our organization.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	I am aware that VAT refunds are available for direct project activities.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

2. Compliance Burden						
Item Code	Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Disagree
	VAT refund applications require excessive documentation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT compliance requires hiring extra staff or consultants.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Preparing VAT-related reports is time-consuming.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT compliance reduces staff productivity in core activities.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	The complexity of VAT procedures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	discourages some NGO activities.					
	Lack of clarity in VAT regulations creates challenges.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

3. Budget Impact of VAT

Item Code	Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Disagree
	VAT obligations reduce funds available for program implementation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Delayed VAT refunds create gaps in budget planning.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT costs affect the allocation of funds to beneficiaries.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT-related expenses increase administrative overheads.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Timely VAT refunds improve financial stability.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

4. VAT Refund Timelines and Project Implementation

Item Code	Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Disagree
	Our NGO experiences delays in receiving VAT refunds.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Delayed VAT refunds negatively affect project timelines	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Unpredictable VAT refund timelines complicate financial planning	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Timely VAT refunds improve operational efficiency.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

5. VAT Refund Effectiveness

Item Code	Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Disagree
	Timely VAT refunds enhance NGO financial capacity.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT refunds increase the efficiency of project implementation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	VAT refunds reduce the financial burden of donor-funded projects.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT refunds improve the long-term sustainability of NGOs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT-related challenges reduce trust between NGOs and tax authorities.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Our NGO faces disputes with tax authorities over VAT claims.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Tax authority staff provides limited support during VAT refund processes.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

6. Effect of VAT on Operational Efficiency						
Item Code	Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Disagree
	VAT increases administrative costs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT obligations reduce program efficiency.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Operational planning is disrupted by VAT-related adjustments.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT obligations delay procurement and service delivery.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	VAT-related tasks reduce internal workflow efficiency.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>