

CHAPTER FIVE: ACCOUNTING FOR INDIRECT TAX**5. INDIRECT TAXES IN ETHIOPIA****5.1. Turn over tax (TOT)**

The turn over tax is payable on goods and services rendered by person not registered for VAT.? The rate of turn over tax is:

1. 2% on goods sold locally
2. 2% on services rendered locally;
 - a. 2% on contractors, grain mills, tractors and combine harvesters
 - b. 10% on others such as consultancy service, legal advice, advertising service ,training ,auditing ,etc

5.1.1 Assessment of Turnover Tax

The Tax Authority determines turnover tax based on the books and records submitted by category 'B' taxpayers. However, if the authority finds that there exists an understatement of tax declaration, it makes an assessment of its own. Similarly, in situations where the taxpayer does not keep records or the submitted records are unacceptable, the assessment is made by the tax authority on the basis of information about the **market price of goods and services**. If the market price of a particular item is not available, the market price of similar goods (and services) will be used for this purpose.

Category 'C' taxpayers (who are not required to keep records as per proclamation 286/2002) pay a presumptive turnover tax. The total turnover for this purpose is determined as per income tax proclamation 286/2002. The provisions of the same proclamation are also followed for the preparation and delivery of assessment notification. The tax authority examines the statements and records submitted by taxpayers and have the power to investigate the details of the same at any time by sending inspectors to the taxpayers' premises. The tax office may also require the custodian of documents, vouchers, and stock to come in person and provide the information if required. If it is necessary to gather information, the tax authority may contact other government offices for the purposes of tax determination. Objections to assessment can be made by giving appeal to Appeal Commission by depositing 50% of tax assessed.

When a taxpayer changes the name of business, address, place of business, constitution, or nature of the main taxable activity, it should be notified to the tax authority within 21 days of doing so.

5.1.2 Tax Period

Tax period is the period for which the turnover is determined and tax is levied. 'B' and 'C' categories of taxpayers are required to collect turnover tax. The Turnover Tax law provides two different tax periods for category 'B' and category 'C' taxpayers. The tax period of category 'B' taxpayers is **three-month period commencing** from the first day of the Ethiopian fiscal year (or if the tax authority

permits, the first day of the Gregorian calendar). The tax period for category 'C' taxpayers who are not obliged to register for VAT would ***one month***.

The tax period of Category ‘C’ is the Ethiopian fiscal year. Note that, for category ‘C’, the tax period for business tax and turnover tax remains the same. At the end of ‘Sene’ 30 every year, taxpayers must be ready for the payment of both the taxes.

5.1.3 Computation of Turnover Tax

The computation of turnover tax is straight forward. The gross receipt is multiplied by the tax rate either 2% or 10% so as to determine the turnover tax liability of the turnover taxpayer.

Example I

ABC Traders had taxable turnover of Birr 120,000 for the three-month ended on ‘Hidar’ 30, 1995. Assuming that the taxpayer belongs to category ‘B’, how much will be the turnover tax payable by the trader? Tax rate is 2%.

- Quarterly turnover Birr 120000
- Tax rate 2%
- Turnover tax $120000 \times 2\% = \text{Birr } 2400$

Example II

The estimated daily sales of a 'printing press business' is Birr 180. The shop is open 300 days a year. How much is the turnover tax payable by the shop?

- Annual sales = $180 \times 300 = \text{Birr } 54000$
- Turnover tax = $\text{Birr } 54000 \times 2\% = \text{Birr } 1080$

5.2. Excise Taxes Excise Tax in Ethiopia

Excise Tax Meaning and Purposes

Different governments levy excise taxes mostly on luxury items and harmful products. Excise taxes are applied either on ***a per unit basis such as per package*** of cigarette or per liter or gallons of gasoline; or a fixed percentage of the sales price. Governments sometimes levy excise taxes to pay for specific projects. **For example** some national governments impose an excise tax on airline tickets to help pay for airport improvements. Excise taxes are usually ***designed to limit consumption of a commodity such as taxes on cigarettes and alcoholic beverages, which are known as “sin taxes”***.

Excise taxes constitute an important source of revenue to the governments in underdeveloped countries. In Ethiopia, excise taxes have expanded owing to increase in production, and increase in

new products that are coming within the purview of tax. In the industrial development of a country, excise taxes function as an important tool in developing the economy. Excise tax in Ethiopia covers only goods produced in the country and goods imported to the country. This helps reduce the administration cost of collection to a certain extent. Usually excise taxes are imposed on ad-valorem basis. It is the determination of duty or tax based on the value of goods. Ethiopian excise tax is not an exception to this rule.

It has been observed universally that the burden of excise tax is falling heavily on the poor (lower income groups) than on the rich (higher income groups). Care should be taken by governments to prevent this situation. At the same time, excise tax should not adversely affect production. It should enable increased production and equitable distribution of wealth and income among different sections of the economy.

Tax policies should be designed to encourage new business units in the manufacture of taxed commodities or expand the existing units to increase production. Excise taxes are also used to regulate consumption and production of certain commodities. Imposing high tax rates on selected items does this. High tax rates on liquor aim at reducing the consumption of liquor, which reduces external costs because alcoholism generates external costs in the form of automobile accidents.

With a view to increase the revenue of the government to provide for public goods and services, and to reduce the consumption of specific goods, the Government of Ethiopia levies excise tax on selected items of goods that are supplied in the country. The current excise tax proclamation, which came into effect at the beginning of 2003, contains reduced tax rates and taxable items compared to the previous proclamations. This may be seen as a step taken by the government to encourage the local production. As per the excise tax proclamation No. 307/2002, the items of goods that are subject to **excise tax in** the country are:-

- a) **Goods imported into the country, and**
- b) **Goods produced locally.**

5.2.1 The Rate, Base and Payment of Excise Tax

Selected items of goods in the schedule accompanying the proclamation, whether imported or produced within the country are liable to tax as per the new excise tax law. When the goods are **imported, the importer** is obliged to pay tax at the specific rate on the CIF of goods. CIF includes the Cost, Insurance, and Freight of the goods imported. On the other hand, tax on **locally produced goods** is determined by the cost of production. The cost of production includes direct material cost, direct labor cost, and overhead cost other than depreciation on machinery.

Excise tax is levied and paid at the rates indicated in the specific schedule provided in the excise tax proclamation No. 307/2002. The rates indicated in the proclamation are equally applied for goods imported and goods produced locally. The rates of tax range from 10% for textile items to 100% for perfumes and motor vehicles. The scope of excise tax proclamation is limited and applies to goods listed in the schedule. If you compare the previous tax declarations with that of the current year, you can observe a reduction in rate for almost all types of goods including a reduction in the highest tax rate from 150% to 100%. You may refer to the appendix given at the end of this unit for further references related to the rates of excise tax. The excise tax is paid on imported as well as locally produced goods listed in the table below at the stated rate. For locally produced goods the excise taxes computed based on the production cost (excluding depreciation cost) of the goods, whereas for imported goods the tax base will be cost, insurance and freight (C.I.F.).

As far as payment of excise tax is concerned, excise tax on locally produced goods will be paid by the **producer not later than 30 days from the date of production**. For imported goods the tax is to be paid by the **importer at the time of clearing the goods from Customs area**.

The schedule attached to the proclamation provides the following list of goods that shall be liable to excise tax when **either produced locally or imported and the rates at which they are taxed**.

Type of Product	Excise Tax Rate (%)
1. Any type of sugar (in solid form) excluding molasses	33
2. Drinks	
2.1 All types of soft drinks (except fruit juices)	40
2.2 Powder soft drinks	40
2.3 Water bottled or canned in a factory	30
2.4 Alcoholic Drinks	
2.4.1 All types of beer & stout	50
2.4.2 All types of wine	50
2.4.3 Whisky	50
2.4.4 Others alcoholic drinks	100
3. All types of pure Alcohol	75
4. Tobacco & Tobacco Products	
4.1 Tobacco Leaf	20
4.2 Cigarettes, cigar, cigarillos, pipe tobacco, snuff and Other tobacco products	75
5. Salt	30
6. Fuel-super Benzene, Regular Benzene, Petrol, Gasoline and other Motor Spirits	30

7. Perfumes and Toilet Waters	100
8. Textile and Textile products	
8.1 Textile fabrics, knitted or woven of natural silk, rayon, nylon, wool, or other similar materials	10
9. Personal adornments made of gold, silver or other materials	20
10. Dish washing machines of a kind for domestic use	80
11. Washing machines of a kind for domestic purposes,.....	30
12. Video decks	40
13. Television and Video Cameras	40
14. Television broadcast receivers whether or not combined with Gramophone, radio, or sound receivers & reproducers	10
15. Motor passenger cars, Station Wagons, Utility cars and Land Rovers, Jeeps, Pickups, similar vehicles (including Motorized caravans), whether assembled together with their Appropriate initial equipment:	
15.1 Up to 1,300 C.C.	30
15.2 From 1,301 up to 1,800 C.C.	60
15.3 Above 1,800 C.C.	100
16. Carpets	30
17. Asbestos and Asbestos products	20
18. Clocks and watches	20
19. Dolls and toys	20

5.3.INTRODUCTION OF VAT

The VAT belongs to the family of sales tax. A VAT may be defined as "*a tax to be paid by the manufacturers or traders of goods and services on the basis of value added by them*". It is not a tax on the total value of the commodity being sold but on the value added to it by the manufacturer or trader. They are not liable to pay the tax on the entire value of the commodity. But they have to pay the tax only on the net value added by them in the process of production or distribution. Thus, the value added by them is the difference between the receipts (from the sale) and payments made to various factors of production (land, labor, capital and organization) in the form of rent, wages, interest, and profits. The value added tax (vat) was first introduced in France in 1954. Thereafter, various European countries introduced it as an alternative to turnover taxes. The introduction of value Added Tax (VAT) is probably the most important tax development in the world. Its applications remained confined to a handful of countries until the late 1960's. Today, VAT is applied in over 120 countries. This makes about 4 billion people or 70% of the world's populations live in countries with a VAT. In these

countries VAT raises about \$18 trillion in tax revenue, roughly a quarter of all governments revenue. The Federal Democratic Republic of Ethiopia recently has joined the over 120 countries of the world that have already adopted VAT into their tax system. VAT is introduced in Ethiopia with the following main objectives.

- To increase government revenues.
- To enhance economic growth and import the ratio relationship between Domestic Production and Government Revenue.
- To enhance saving and investment as it is essentially a consumption tax and does not tax capital.

The key feature of this form of tax is that it is charged and collected throughout the production and value adding processes with provisions for tax payable to be reduced by the tax point in respect of purchases. It allows collection of tax on the *added value* wherever a sales transaction is conducted. The law governing VAT requires the following persons to pay value added tax.

- A registered person – a person who is registered or required to be registered
- a person carrying out taxable import of goods, with respect to such import.
- A non-resident person who performs services without registration, with respect to such services.

A person who is registered is taxable as soon as registration for VAT takes place. But a person who fails to adhere to the registration requirement is considered to be taxable beginning from the start of the accounting period following the period the obligation for registration arose.

5.3.1 Registration for VAT

This section covers some essential points related to getting registered for VAT. Registration may take different forms – *voluntary or obligatory*. Hence, each form of registration shall be discussed. Moreover, registration procedures and matters related to cancellation of registration are also addressed in this section. Registration takes two forms. In compulsory (obligatory) registration taxable persons are required to get registered when they meet some criteria. Others can still register on voluntary basis depending on the nature of their activities.

Forms of Registration

a. Obligatory Registration

A person who carries on a taxable activity is required to get registered if at the end of any period of the 12 calendar months the person made taxable transactions whose value exceeds Br. 500,000. In addition to this, a person must get registered for VAT if there is a reasonable ground to expect that the person's taxable activity shall exceed Br. 500,000 at the beginning of any period of 12 calendar

months. However, carefully note that the Birr 500,000 threshold may be increased or decreased by a directive issued by the minister of Finance and Economic Development.

A person required to register has to file an application for registration no later than the last day of the month after the end of the period in which its activities exceed the threshold or the last day of the month of the period the expectation to exceed the threshold is made.

b. Voluntary Registration

A person not required to be registered for VAT may voluntarily apply to the authority for such registration, if he is regularly supplying or rendering at least 75% of his goods and services to registered persons

5.3.2 Computation of Value Added

The value added by a firm can be calculated in any one of the following two methods:

A) Addition Method

Under this method, the value added by a firm i.e. the tax base is determined by adding the payments made by the firm to the various factors of production such as wages, rent, interest and profits.

B) Subtraction Method

In this method, the value added by the firm is determined by subtracting the cost of production from the sales receipts of the firm.

But, in these two methods, the tax liability is identical.

Example: Now we can explain the concepts of VAT with the help of the following example. Let us assume a consumer product is clothing and the number of stages involved is six before it reaches the ultimate consumers and the rate of tax is 10%.

No.	Stage	Receipts Birr.	Value Added	Tax 10%
1.	Farmer	700	700	70
2.	Ginner	1, 000	300	30
3.	Spinner	1, 500	500	50
4.	Weaver	2, 100	600	60
5.	Wholesaler	2, 300	200	20
6.	Retailer	2, 400	100	10
			2, 400	240

In the above example, final sale price to consumer is Birr.2 400 and the total value added is Birr.2 400.

From the above table, it can be understood that there are six stages involved in the process of converting cotton into clothing and before it reaches ultimate consumer. The ginner buys cotton from the farmer at a price of Birr.700 per quintal and sells the cotton after ginning to the spinner for Birr.1, 000. The Spinner, for converting the cotton into yarn, has added Birr.500. The weaver converts the yarn into clothing, which he sells to the wholesaler for 2 birr per 100 bale of clothing. The wholesaler has added value of Birr.200 and sells the clothing to retailer for Birr.2, 300. The retailer finally sells the clothing to the consumer for Birr.2, 400. The remaining value of Birr.100 (difference between price of wholesaler and that of retailer) represents value added by the retailer.

From the above example, it can be observed that the final retail price paid by the consumers is simply the sum of the value added at each stage of production and distribution. The value added tax is assessed at each stage of production.

5.3.3 Advantages of Value Added Tax

The VAT has the following advantages.

A. Easy to Administer

Since the impact of VAT system is like the single point sales tax system, the administration becomes easier.

B. Effective and Efficient

The VAT replaces inefficient and poorly administered taxes such as taxes on capital goods and those that reduce the tax base and involved in difficult administration. Hence, it is considered as more effective and efficient.

C. Neutrality

VAT is expected to be perfectly neutral in the allocation of resources i.e. in the forms of production and commercialization. Thus, it helps the economy in adopting the forms of production that are economically more suitable.

C. Reduce Tax Evasion

In the case of VAT, the tax is divided into several parts depending on the number of stages of production and sale. Thus, the possibility and intention to evade tax is considerably reduced.

D. Possibility of Crosschecking

In VAT system, cross checking becomes possible. When a firm purchases raw material from another firm and pays tax on such purchase, it has to maintain records about from whom it purchased goods and the amount of tax paid by it etc. The firms maintaining these records alone can reclaim the tax already paid. The other firm also has to maintain such records. This obligation makes tax evasion difficult.

F. Less Tax Burden

Under VAT, the tax is collected in small fragments at different stages of production and sale. Hence, the taxpayers feel the burden of the tax less.

G. Encourages Exports

Under VAT system, the tax burden is less and it reduces the cost of production. Such a reduction in the prices of commodities increases the competitive efficiency of the firms in the global market.

Besides, to promote exports, the Government may refund the taxes paid on the exportable goods. It is possible only when the tax paid is easily identifiable. In the system of VAT, it is easy to separate the tax from the cost of production, which is not possible in the case of other taxes. In this way, it encourages the exports.

H. Improves Productivity

In the system of VAT, a firm has to pay tax even though it runs into loss. It cannot claim any exemption for loss because it pays taxes on the value produced and not on profits. So the firms will always try to improve their performance and reduce the cost of production. As a result, the overall productivity of the country will be improved.

I. Burden of Tax is Shared by all Factors

The value added tax falls on the wages, interest, rent and profits. As such, the burden of tax is shared by all factors of production.

J. Major Source of Revenue

In most of the countries, the value added tax contributes a considerable amount of revenue to the Government. This makes it a reliable and valuable source of revenue.

5.3.4 Disadvantages of VAT

VAT system has the following disadvantages.

A. Not a Simple and Easy System

VAT System is not easy and simple to adopt in under developed countries where the tax administrative set-up is inefficient and inexperienced to understand any complicated tax structure.

B. Requires Advanced Economic Structure

The proper implementation of VAT system requires advanced financial and economic structure and the firm should be in the habit of keeping proper accounts. Hence, it becomes difficult to implement the system in all types of economy.

D. Uneconomical

This system involves high cost of administration, assessment, verification, collection etc. Hence, it is highly uneconomical.

G. Additional Burden

Under VAT system, the manufacturers and shopkeepers have to observe various legal formalities in the form of maintaining various records, accounts books etc. The verification of those records puts additional burden to the tax enforcing authorities.

H. Inflationary in Nature

Under VAT system, the tax burden will be less which results into surplus income in the hands of consumers. Thus, there is a possibility for wide spread inflation in the economy. But, this argument does not hold good. Because, VAT itself cannot be inflationary and the other accompanying policies of the Government might make it so.

I. Regressive in Nature

According to **Allan A. Tait**, a straight forward single rate VAT, with few exemptions would tax lower income households more heavily than the higher income household. Thus, it is considered as regressive in nature.

Even though the VAT system is suffering from the above said drawbacks, the benefits sought are more and it can be applied to the Indian economy after rationalization, modification and restructuring of the system. Various Tax Reforms Committees and other eminent economists advocated this system as suitable to the prevailing economic conditions of the developing countries.

5.3.5 Exempt Transactions

The following types of supplies of goods (other than by way of export) and rendering of services, as well as imports of goods, are exempt from payment of VAT to the extent provided by regulation:

- The sale or transfer of a used dwelling, or the lease of dwelling;
- The rendering of financial services;
- The supply or import of national or foreign currency (except for that used for numismatic purposes), and of securities;
- The import of good to be transferred to the National Bank of Ethiopia.
- The rendering by religious organizations of religious or church related services;
- The import or supply of prescription drugs specified in directive issues by the Minister of Health, and the rendering of medical services.
- The rendering of educational services provided by educational institutions, as well as child care services for children at pre-school institutions;
- The supply of goods and rendering of service in the form of humanitarian aid, as well as import of goods transferred to state agencies of Ethiopia and public organizations for the purpose of rehabilitation after natural disasters, industrial accidents, and catastrophes;

- ↪ The supply, kerosene, and water;
- ↪ Goods imported by the government, organizations, institutions or projects exempted from duties and other import taxes to the extent provided by law or agreement.
- ↪ Supplies by the post office authorized under the Ethiopian Postal Services Proclamation, other than services rendered for a fee or commission.
- ↪ The provision of transport;
- ↪ Permits and license fees;
- ↪ The import of goods to the extent provided under schedule 2 of the customs Tariffs Regulations;
- ↪ The supply of goods or services by a workshop employing disabled individuals if more than 60% of the employees are disabled;
- ↪ The import or supply of books and their printed materials to the extent provided in regulations.

Moreover, the ministry of finance and economic development may exempt goods and services other than these by directive. Carefully note that a supply of goods or services is not an exempt supply if it is charged at the rate of zero percent.

5.3.6 Preparing Tax return and payment

This section covers the filing of VAT returns by a registered person, and the payment of tax by registered persons and importers.

1. Filing tax return

According to this Article, every registered person is required:

- a). to file a VAT Return every month whether or not tax is payable in respect of that period.

The period covered by the return is called a tax period.

- b). He has to fill in details of the supplies made and received in that period and pay the total tax owed to ERCA, or claim a further credit or repayment of tax as the case may be.

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

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

2. Form and Manner of Filing Returns: A return must be made in the form and furnished in manner prescribed by the Authority, and must include the information necessary to calculate the tax payable for the accounting period and be furnished in the manner prescribed by the Authority.

3. VAT Refund

If at least 25 percent of the value of a registered person's taxable transactions for the accounting period is taxed at a zero rate, the Authority will refund the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within a period of two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

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

However, in all cases where an amount refunded to a person is established by the Authority to have been made erroneously, the Authority may demand the return of such amount. Moreover, the Minister of Finance and Economic Development determines the manner in which and the amount of the tax collections that will be retained for VAT refunds.

Where the Authority is satisfied that a person who made an application for refund has overpaid tax, the Authority will first apply the amount of the excess in reduction of any tax, levy, interest or penalty payable by the person under this proclamation, the customs proclamation, the income tax proclamation, or the sales and excise tax proclamation. Following this the authority, then, repays any amount remaining to the person if the amount to be refunded is more than 50 birr.

If the Authority does not pay the refund by the date specified in the proclamation, for a registered person who has overpaid tax and hence entitled to a refund, then, the Authority will pay the person entitled to the refund, interest set at 25% (twenty five percent) over and above the highest commercial lending interest rate that prevailed during the preceding quarter. In general, if the Authority does not pay the refund in a timely manner it must pay interest calculated from the date on which the refund was due until the date on which the payment of the refund is made.

The proclamation provides, however, that the Authority is not obliged to refund excess credits if the amount to be refunded is not more than 50 Birr. If the amount eligible for refund is 50 Birr or less, this amount can be carried forward and credited against tax due in the subsequent accounting period.

Where a registered person applying for a tax refund has failed to furnish a required return, the Authority may withhold payment of any amount refundable until the registered person furnishes such return.