CHAPTER 3

VALUE ADDED TAX
Proclamation No. 285/2002

Definition

- Value added tax (VAT) is a tax on ***exchange***. It is levied on the value added that result from each stage of exchange. It is an ***indirect tax*** in that the tax is collected from someone other than the person who actually bears cost of the tax. Businesses are simple agents of the tax authorities.
- Value Added Tax (VAT) is a general ***consumption tax*** assessed on the value added to goods and services.
- It is a general tax that applies, in principle, to all **commercial activities** involving the production and distribution of goods and the provision of services.
- It is a consumption tax because it is borne ultimately by the ***final /end consumer***.
- It is charged as ***a percentage of prices***, *which means that the actual tax burden is* visible at each stage in the production and distribution chain.
- It is collected fractionally, via a ***system of deductions*** whereby taxable persons (i.e., VAT-registered businesses) can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business

VAT is a tax on ***the added value*** *on a good or service.*

The value added is imposed on the value that the business entity adds to the goods and services that it buys from suppliers or other firms. This value is added partly owing to the fact that processing or handling purchased materials /items requires additional labor or capital that shall be calculated out from the final product/service and partly because buildings machinery, etc are devoted to preserve the good or provide the service to its destination . Costs of production and preservation shall be borne /deducted from the proceeds of the sale of the good /service (value added) which is serving as tax bases for VAT.

How does the tax work?

The classic ingredients of VAT are:

- The tax is charged on certain ***transactions*** such as the sale of goods, the provision of services, and other types of supplies.
- It is charged ***at each stage*** of the production and distribution chain by businesses and other persons carrying on a continuous or taxable activity.
- Such businesses do not incur the cost of the tax - they simply ensure that it is charged when they supply a commodity (collecting the tax on behalf of the Revenue) and claiming a ***credit*** from the Revenue for tax paid on their business inputs.
- Specified supplies are charged at the **rate of 0%** or are ***exempt*** from the tax. ***Zero rated businesses*** can claim a ***credit*** for VAT paid on inputs, exempt businesses cannot. The cost of the tax is therefore borne by businesses, which make exempt supplies, and by ***unregistered end consumers***.
- Both parties pay the tax when acquiring commodities but are unable to claim a compensating VAT credit

Basic Notion

- The Value -Added Tax (VAT) proclamation No ***285/2002*** which has rescinded and replaced the sales and excise tax proclamation No. 68/1993 (as amended) and which has come into force as of January 1st, 2003 is a consumption tax which is levied and paid as value added tax at a rate of 15 percent of the value of every taxable transaction by a registered persons, every import of goods, other than an exempt import and an import service rendered in Ethiopia for a person registered in Ethiopia for VAT or any resident legal person by a non resident person who is not registered for VAT in Ethiopia.
- (Article 7 (1) (a)-(c) and Article 23 (1) and (2))

Taxable activity

- ***It*** is ***any activity***, which is carried on ***continuously***, or ***regularly*** by any person in Ethiopia, or partly in Ethiopia, whether or not for a pecuniary profit that involves, in whole or in part, the supply of goods or services to another person for ***consideration***. (Article 6 (1) and (2))
- True, not all supplies of goods and service are taxed. For instance, the income tax proclamation allows exemptions for social, economic or other reasons. The VAT proclamation under Art 6 clearly states what kind of activity or transaction is subject to imposition of VAT.
- As per the definition, as far as there **is regular or continuous** (almost the same) supply for consideration whether profit is due or not. The terms regularly and continuously implies the frequency of the transaction. This helps us to exclude occasional /seldom supply of goods or services from the ambit of taxable activity under VAT regime.
- Another point of emphasis at this juncture is the mere fact that the activity fulfills the necessary conditions under Art 6 doesn't suffice, the person carrying the taxable activity shall be ***registered for VAT.***

- ***A taxable transaction*** is a ***supply*** of goods or a ***rendition*** of services in Ethiopia in the course or furtherance of a taxable activity other than an ***exempt supply***. (Article 7(3))
- Besides, from cumulative readings of art 7(1)(a) and 7(3) we can appreciate that: Taxable transaction ***relates to a supply of goods or rendition of services***
- The supply of goods or rendition of services is made in the course or furtherance of taxable activity.
- Taxable transaction doesn't relate to exempted supplies under Art 8 and

=>The taxable transaction shall be carried out by a registered person.

- ***Supply*** means the sale of goods or rendition of services or both and rendition of services means anything done, which is not a supply of good or money. (Article 2(17) and Art. 4(1))

For the purpose of the VAT proclamation the following are considered as taxpayers on whom the VAT law is applicable. These are: -

(a) A person who is registered or is required to register for VAT;

(b) A person carrying out a taxable import of goods to Ethiopia;

(c) A non-resident person who without registration for VAT renders service in Ethiopia for any person registered in Ethiopia for VAT or any resident legal person

(Article 3(1), (a)-(c)-cum Article 23 (1) and (2))

VAT Rate

- The VAT law contains **two VAT rates**. One is the **standard** 15 percent rate and the other is **zero-rated**.

Zero-Rated Transactions

- As the name indicates, a zero-rated transaction is ***a taxable transaction*** that is taxed at zero-rate of tax. In other words, the transaction by itself is taxable subject to VAT in the sense included under Art 7(3) "taxable transaction" But, the Law has given blessings so that the transaction (supply of goods or rendition of services) are completely free from tax.
- This kind of incentive is allowed basically to encourage export. A close look at with the listings tells us that zero-rated transactions are directly or indirectly connected with export goods or services to make domestic exporters more competent before international arena.

The following ***taxable transactions*** are charged with tax at a rate of zero percent.

A. The ***export*** of goods or services

B. The rendering of transportation or other services directly connected with international transport of goods or passenger, as well as the supply of lubricants and other consumable technical supplies taken on board for consumption during international flights

C. The supply of gold to the National Bank of Ethiopia; and

D. A supply by a registered person to another registered person in a single transaction of substantially all of the assets of a taxable activity or an independent functioning part of a taxable activity as a going concern.

[Article 7 (2) (a) - (d)]

- There is a basic difference between ***VAT exemption*** and ***zero rate VAT***. The difference is that though zero rate transactions do not pay VAT on the goods and services they render under transactions listed in (a) – (d) above, for the purpose of VAT registration they are considered as taxable service thus enabling and making these transactions eligible for collecting tax ***rebate***.
- This has the advantage of granting ***VAT rebate*** which can help redress in put tax paid on purchase of goods and services necessary for the furtherance of the zero rated transactions.
- On the other hand, ***VAT exemptions*** granted by the VAT law does not allow for the collection or entitlement of VAT rebate for the simple reason that they are assumed not to have paid in put tax, therefore disabling exempt categories from registering for VAT and taking advantage of the VAT rebate provisions.

Registration - two types_ mandatory/obligatory voluntary

- Under the VAT law any person who carries on ***a taxable activity*** and at the end of any period of 12 calendar months has made, during that period, taxable transactions the total value of which exceeds 500,000 Birr or at the beginning of any period of 12 calendar months there are reasonable grounds to expect that the total value of taxable transactions to be made by the person during the period will exceed 500,000 Birr, has the obligation to register for VAT. (Article 16(1)(a) and (b))
- According to Article 17, a person who carries on taxable activity and is not required to be registered for VAT, may ***voluntarily apply*** to the Tax Authority for such registration, if he regularly is supplying or rendering at least 75% of his goods and services to registered person.

Exemption for Specific Categories of Goods and Services

- Tax-exempt goods and services are supplies on which VAT, both the standard rate and zero-rate tax, are not paid on.
- An exempt transaction is a transaction not subject to VAT. Thus the transaction is not considered taxable transaction for social, economic or development reasons.
- If a person who is engaged in a taxable activity that fully falls under the tax-exempt category, such a person cannot register for VAT.
- If a person is engaged partially in a tax exempt category activity and partially in a taxable activity, such person can not register for VAT and be legible for tax rebate which could be beneficial to redress cost paid for in put tax on his taxable transactions.
- Under the VAT Law, the following types of supplies of goods (other than by way of export) or rendering of services as well as the following types of imports of goods are also exempt from payment of VAT;

A. The sales or transfer of a used dwelling, or the lease of a dwelling;
B. The rendering of financial services;
C. The supply or import of national or foreign currency, and of securities;
D. The import of good to be transferred to the National Bank of Ethiopia;
E. The rendering by religious organizations of religious or church related services;
F. The import or supply of prescription drugs and the rendering of medical services;
G. The rendering of educational services provided by educational institutions, as well as child care service for children at pre – school institutions;
H. The supply of goods and rendering of services 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;

I. The supply of electricity, kerosene, and water;

j. Goods imported by the government, organizations, institutions or projects exempts from duties and other import taxes to the extent provided by law or by agreement;

k. Supplies by the post office;

l. The provision of transport;

m. Permits and license fees;

n. The import of goods to the extent provided under schedule two of the customs tariffs regulations;

o. The supply of goods or services by a workshop employing disabled individuals if more than 60 percent of the employees are disabled; and

p. The import or supply of books and other printed materials.

(Article 8(2) (a)-(p))

- All The aforementioned exemptions have a common feature and that is; they are designed and intended to encourage and enhance the health, education and financial sector of the economy and to protect and promote social and public interest; and the exemptions have been granted for ***economic, administrative or social reasons***

How does it differ from income tax?

- The cost of the tax is borne by VAT exempt institutions and unregistered end-consumers.
- Obviously, the latter consumes more so that VAT primarily taxes the ***non-business end consumer***. In comparison, income tax applies across all spectrums of the community.
- VAT differs radically in a second respect from income tax. Income tax taxes **income** (i.e., amounts coming in). VAT taxes **spending** (i.e., amounts going out). Economic theory therefore classifies income tax as a "***direct tax***" and VAT as an "***indirect tax***" or a "consumption tax".

Non - compliance with VAT Proclamation

Non-compliance with VAT Proclamation

- failure to register for VAT as per VAT registration requirement,
- failure to issue a tax invoice,
- failure to maintain recorder such as original tax invoices received and a copy of tax invoices issued and
- failure to file timely return shall be liable to administrative penalties ranging from a fine 100 percent of the amount of tax payable and a fine of up to 50,000 Birr.

- In addition to administrative penalties tax offenders such as tax evasion, making false or misleading statement, and failure to notify are all criminal offences under Ethiopian law.
- Accordingly, tax fraud - making false or misleading statements is punishable with a fine ranging from 1000 Birr to 100,000 Birr and an imprisonment ranging from 3 years to five years where the making of false or misleading statement is made knowingly or recklessly
- such an offence is punishable by a fine of up to 200,000 Birr of an imprisonment of up to 15 years.

Tax evasion

- tax evasion simply refers to intentional effort by people, corporate body, trust and other institutions to illicitly refuse to pay their tax and reporting true and fair value of their earnings by means of evading.

TAX EVASION UNDER ETHIOPIAN INCOME TAX LAWS

- Ethiopian Income tax proc. no.286/94 was among the first laws that introduce the concept of tax evasions with its contemporary development. Section 9, art 96 of the proclamation comes with definition of the term.
- Accordingly, "A taxpayer who evades the declaration or payment of tax commits an offense and, in addition to the penalty for the understatement of income referred to in Article 86, may be prosecuted and, on conviction, be subject to imprisonment for a term of not less than five (5) years"
- Pursuant to the above article tax evasion is regulated having two (2) aspects. Those include:
- **evasion of declaration(assessment)**
- **evasion of payment**