

**The VAT Regime Under Ethiopian Law
with Special Emphasis on Tax Exemption:
The Ethiopian and International Experience**

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Table of Contents

1. Introduction	1
2. History and Description of VAT Generally	6
2.1 Definition	6
2.2 Background	6
2.3 How does the tax work?	7
2.4 How does it differ from Income Tax?	7
2.5 Why has the tax spread throughout the world?	8
2.6 Why are there different forms of the tax?	8
2.7 Will the Internationalization of VAT continue, stop or contract?	10
3. The VAT Regime in Ethiopia	11
3.1 Basic Notion	11
3.2 VAT Rate	12
3.3 Registration	13
3.4 Exemption for Specific Categories of Goods and Services	13
3.5 Tax Credit, Procedures for Filling Tax Return and Payment of VAT and VAT Refund or Rebate	15
3.5.1 Tax Credit	15
3.5.2 Procedures for Filling of Tax Return and Payment of VAT	16
3.5.3 VAT Refund and Rebate	17
3.6 Non Compliance with VAT Proclamation	17
3.7 The Implication of VAT on NGOs in Ethiopia	18
3.8 The Implication of Other Taxes on NGOs in Ethiopia	18
3.8.1 Import Custom Duties	18
3.8.2 Income Tax Exemption	19
3.8.2.1 Income Tax Exemption from Income Generation Activities and Donations	19
3.8.2.2 Income Tax Exemption of INGO International Staff	21
3.9 Others	24
3.9.1 Stamp Duties	24
3.9.2 Lease Free Land Grant	24
4. International Experience and Best Practice on VAT and VAT Exemption for NGOs	26
4.1 Africa	26
4.1.1 South Africa	27
4.1.2 Kenya	28

4.1.3	Uganda	29
4.1.4	Tanzania	29
4.1.5	Rwanda	29
4.2	Asia	30
4.3	Newly Independent States	30
4.3.1	Armenia	32
4.3.2	Kazakhstan	32
4.3.3	Kyrgyz Stan	32
4.3.4	Tajikistan	33
4.3.5	Ukraine	34
4.4	Central and Eastern European Countries	34
4.4.1	Croatia	37
4.4.2	Hungary	38
4.4.3	Latvia	38
4.4.4	Lithuanian	38
4.4.5	Poland	38
4.4.6	Romania	39
4.4.7	Slovakia	39
4.5	European Union Countries	39
5.	The Rational of Tax Exemptions and for Offering Beneficial Tax Treatment to NGOs	42
6.	The Rational of Exempting NGOs from VAT	45
7.	The Precedence of Granting Tax Exemption in Ethiopia	48
8.	Conclusion and Recommendation	51
	Source Materials	54

1. Introduction

Most NGOs in Ethiopia had their origin in the famine of the mid 1970s and 1980s. In this context, NGOs have primarily acted as agents of relief, charity, welfare and deliverers of services.

Today the sector having developed currently has reached around 1500 according to Ministry of Justice and those, which are classified, as development oriented and registered with the Disaster, Prevention and Preparedness commission (DPPC) are approximately 419 (291 local and 128 international NGOs).

Studies show that NGOs provide different types of services to 15% of the total population and during a five years period (1996 – 2000), they implemented projects worth Birr 5.96 billion where each year the financial contribution (for NGO projects) has increased. A break down of this shows that NGOs investment of their finance is 21% in SNNPRS, 23% in Amhara, 20% in Oromiya, 18% in Addis Ababa and 13% in Tigray.

However, there are relatively few NGOs, given the size of the population and the scope of the developmental challenges.

With the advent of new political and economic developments, the identity and role of NGOs has been transformed and has gradually been replaced with development activities and as a result the role of NGOs and their relationship with the community they serve, the government, donors and among themselves has undergone dramatic changes.

Accordingly, NGOs are currently operating in a dynamic and fast changing policy and environment. One such dynamic policy shift involves the new tax regime namely Income Tax and the Value-Added Tax (VAT) of Ethiopia, which seems to have caught the NGO community unaware and unprepared to deal with it.

The new tax regime, especially VAT, is indeed a steep learning curve for NGOs and the tax authorities as well.

This issue has become a common topic in Ethiopia, both for those working in the sector and those outside of it. And as of late, the lack of information and clarity on tax issues as it applies to NGOs, has become a cause of anxiety and uncertainty. It has thus become a topical issue warranting utmost priority. One of the most critical of these tax regimes is the current VAT regime.

The government has and is encouraging and supporting the existence and operation of NGOs in Ethiopia. At the same time the government seems to have realized that the NGO sector mobilizes "enormous" resources and was handling substantial cash in flow for which it felt it had no control over in the allocation and use.

It is against this background that the Ministry of Justice has been seized with, lately, of undertaking the task of drafting a proclamation to regulate the registration and operation of NGOs in Ethiopia.

In a similar vein, the Ministry of Finance and the Inland Revenue Authority, have slowly and gradually developed an interest in the activities and operations of NGOs, with the view of increasing revenue collection to meet the ever-increasing financial requirement necessary for implementing the exponentially growing national budget.

It is against this background that the new Income Tax Law and the Value -Added Tax Proclamations have been enacted recently with the objective of widening and deepening the revenue collection and tax administration of Ethiopia.

With regards to the issue of tax exemption, it should be noted from the outset that there are no universally agreed world wide practice that lay the principle or foundation for according NGOs favorable and/or beneficial tax treatment nor is it a priority when assessing competing demands on limited government resources.

In this context, the issue of tax treatment of NGOs involves two distinct sub-issues, (a) tax treatment of NGOs, itself and (b) tax treatment of contributions to NGOs by individuals, corporations and others.

In several countries, tax benefits appear in three main areas, these include exemption from customs, duties on imported goods, exemption from income tax e.g. income from employment and income from income generating activities and exemption from land lease or rented payments.

This paper attempts to raise a host of issues the merit serious consideration. For example, why should Ethiopia accord beneficial tax status to NGOs? What is the rationale for beneficial tax treatment? What are the compelling and convincing arguments that can be forwarded in favor of such treatment?

If favorable tax treatment is to be accorded to NGOs, should such treatment apply across the board to all types of NGOs or only to certain types? Or should it be reserved, in whole or in part, just for some types of NGOs?

Should differentiation of tax treatment be considered in terms of type of NGOs? Or in terms of the type of the purpose it serves?

What type of taxes should the tax treatment cover? Income tax, consumption taxes on various types of purchases of NGOs like sales tax, value-added tax, exercise tax, turnover tax, property tax, import taxes or duties?

In a country like Ethiopia, where the vast majority of the people have little or no disposable income exemptions of public benefit organizations (PBOs) from tax on their income may be more conducive to their development thus providing tax incentives to

their donors. If such is the case, should beneficial tax treatment be accorded to mutual benefit organizations (MBOs), which principally serve the interest of their members or public benefit organization (PBOs), which benefit the public or some defined segment of it, which deserve or are entitled to greater benefits from the state? Should such tax treatment be extended preferentially or even exclusively to PBOs?

What procedures must be established for monitoring the continued appropriateness of such status for particular NGOs?

Most INGOs international staff contracts assume no payment of income tax in the country of operation; income tax is often already deducted in the home country of the international staff.

If such staff is compelled to pay income tax on employment, should such tax be paid from program budgets? Could this reduce the impact of INGOs service delivery and leave a gap in planned development and relief activities? Will such practice subject expatriate staff to double taxation? If so what relief or remedy is available to them?

Wouldn't collecting taxes from employees whose payroll is administered in the INGOs home office be expensive and complex to monitor and administer?

Favorable tax treatment for NGOs, calls for or goes hand - in - hand with forestalling by legislating a comprehensive screening mechanisms whereby only the NGOs earmarked for favorable tax treatment receive the intended benefit.

In this regard it is necessary to adopt rules and procedures to prevent abuse of the system and it is incumbent upon both the government the beneficiaries of the favorable tax treatment, to ensure that these rules are enforced scrupulously and rigorously. In this regard how should the NGO Community Present itself and it's case? What are the necessary steps and measures that it must take in order to establish its credibility and legibility for being accorded tax exemptions?

Addressing the issue of favorable tax treatment for NGOs operating in Ethiopia, calls for the adoption of a clearly defined strategy. Does the NGO community have such a strategy? What should the strategy outline look like?

How should a consensus be built around such a strategy?

This paper attempts to address the aforementioned issues and it also lays out the basic legal principles and policy underpinnings of the current tax regime in Ethiopia and offers points for discussion and consultation between the NGO community and the government by defining and articulating in a concrete way the issues that need to be addressed in order to create an enabling and conducive favorable tax environment for NGOs operating in Ethiopia by developing short term and long term strategies and recommendations that are designed to meet the desired objectives.

Tax laws affecting NGOs in Ethiopia fall under a broad category of taxes such as income tax – profit tax on incoming generating activities, income from employment or payroll tax, property, real state and land tax, customs duty – import duty, stamp duty and consumption tax or value added tax (VAT).

The latter currently poses a serious problem testing the limits of largesse and financial resources of NGOs operating in Ethiopia. Because NGOs purchase goods and services like other entities and this exposes them to consumption tax – VAT even though they may be exempted (by design or default) from more formal requirements of income taxation.

Since consumption tax has become more onerous and burdensome for NGOs than income tax it has been found necessary to pay close attention to the VAT regime in Ethiopia which was introduced on the 1st of January 2002 and which is becoming entrenched and potent as its implementation is being pursued with zeal and determination by the tax authorities of Ethiopia.

In light of the foregoing, the central theme and focus of this paper is the VAT regime in Ethiopia, which has become a priority and NGOs operating in Ethiopia.

This paper has attempted to raise and identify a broad, but not comprehensive, range of critical issues relating to the treatment of the VAT regime.

Accordingly the second part or chapter of this paper lays down the foundation and background of our discussion by providing the history and description of VAT generally. In this section the conceptual definition of VAT, VAT's background, how VAT works, how it differs from income tax, why it has spread throughout the world, why there are different forms of the tax and the issue of whether the internalization of VAT will continue, stop or contract, have all been touched upon with the view of shading light on the treatment of VAT at the conceptual level.

The third part or chapter three of this paper delves into the central theme of the paper and examines the VAT regime in Ethiopia. It does so by looking closely into issues relating to the basic notion of VAT, VAT rate, VAT registration, exemption for specific categories of goods and services, tax credit, procedures of filling of tax return and payment of tax and VAT refund or rebate under Ethiopian tax law.

With this legal background it, albeit briefly, it examines the implication of VAT on NGOs in Ethiopia. In this regard, it indicates major areas of concern.

In a similar vein, it brings to the fore the implication of other taxes such as turnover tax import customs duties, income tax and other taxes such as stamp duties and lease free land grant, on NGOs operating in Ethiopia.

Though the magnitude and urgency of these taxes might be arguably lesser than that of VAT, it goes to indicate and remind the reader that there are also other tax issues that are of concern to the NGO community in Ethiopia.

The fourth part of this paper deals with and addresses the issue of international experience and best practice regarding VAT and it does so by presenting, an illustrative and by no means exhaustive, list and sampling of various countries with the view of providing a comparative analysis.

The countries treated in this part cover a wide geographic area and are intended to be representative and reflect international experience and best practice regarding the treatment of VAT. In this regard African, Asian, newly independent states, European Union, Eastern and Central European countries, North American countries have been included in the survey.

The fifth part of the paper points out the rationale of tax exemptions and for offering beneficial tax treatment to NGOs. In this regard it indicates the basic principles governing tax exemptions, the means and modalities of granting such exemptions and the policy considerations that are taken into account by governments in granting tax exemptions to NGOs.

The sixth part, following on the discussion of the fifth part and basing its reasoning on grounds laid therein, examines the rationale of exempting NGOs from VAT.

The seventh part of the paper tries to outline a broad, but not comprehensive, strategy for working towards a favorable and enabling tax environment for NGOs operating in Ethiopia in the context of the current realities of Ethiopia. It also offers some recommendations as to how best to pursue the objectives outlined in the strategy.

It should be noted that this paper has been presented for starters and is intended to provoke discussion with the view of enriching it with comments from stakeholders and further developing and concretizing these broad and general issues, observations and opinions forwarded in the paper.

In this regard it attempts to point the way forward indicating the major signposts along the way but leaving the details in between the road map for further deliberation and closer scrutiny.

2. History and Description of VAT in General

2.1 Definition

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 consumer. It is not a charge on companies. It is *charged as a percentage of price*, 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 activities. This mechanism ensures that the tax is *neutral* regardless of how many transactions are involved.

2.2 Background

"VAT" - value added tax - has spread throughout the world since its introduction in 1955. Its format has changed and now incorporates what was once an offshoot - "GST" (goods and services tax).

France is credited with first implementing VAT. It did so in 1955. The tax spread through Europe, South America and parts of Africa in the 1960s and 1970s before taking a hold in other regions. For example, the tax spread throughout the South East Asia/Pacific region from 1984 (Indonesia) to 1999 (Australia).

Today, over 128 countries have the tax. All members of the OECD and all leading economies in the world have a VAT (or very broadly comparable tax), apart from the US. For most of the twentieth century, the principal federal tax on individuals in the United States has been on income, whether it is earned from labor (wages and salaries) or capital (interest, dividends, and capital gains). But a growing number of economists and politicians have concluded that the United States should replace the income tax-partially or entirely- with a tax on consumption.

Most of the political debate over a consumption tax has centered on whether the United States should adopt a value-added tax (VAT) similar to the ones that European countries have. While a VAT definitely is a tax on consumption, it is not the kind that most consumption-tax advocates prefer. What's more, the debate over whether to add a VAT to the U.S. tax code has obscured the more basic issue of whether to tax income or consumption.

Every Member State of the European Union has a Value Added Tax (VAT). The First VAT Directive of April 11, 1967 (as amended) required that Member States replace their general indirect taxes by a common system of value added tax. In fact, the assessment base for the Member States' VAT constitutes one of the critical components of "own resources"-the EU's budgetary revenue.

Yet the laws establishing the VAT are national laws, each framed within certain parameters specified by the EU in the Sixth Council Directive 77/388/EEC (as amended) on the common system of VAT and the uniform basis for its assessment. This Sixth VAT Directive aims to ensure that each Member State has a broadly identical "VAT base"-VAT levied on the same transactions. Its subsequent amendments have attempted to remove anomalies.

2.3 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.

These then are the characteristics of value added tax regimes. Minor variations occasionally apply. In Canada and Australia, for example, exempt financial entities can claim a partial VAT credit on certain expenses.

2.4 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".

2.5 Why has the tax spread throughout the world?

Economic theory has been central to the spread of the tax throughout the world. Economic theory changed its assessment of VAT throughout the 20th century. To greatly oversimplify:

1. Up to 1950, the tax was regarded as undesirable because it discriminated in the market place via influencing consumers' decisions. Economists during this period assumed that an indirect tax would tax commodities at different rates. Hence, one commodity might be taxed at 10% and a comparable one at 20% - thereby providing a tax favored market place for the former. Income tax was favored over this discriminatory tax.
2. Throughout the 1950s and 1960s, the tax was regarded on a par with income tax. This was because income tax was also discriminatory. For example, income tax taxes income so as to provide a bias for leisure (not taxed) over work (taxed). Income tax could not therefore be viewed as superior to VAT.
3. During the 1970s, VAT began to be classified as the preferred tax. Economists concluded that taxing all goods and services at a single rate meant that there was no resulting bias to purchase one commodity over another. A single rate comprehensive VAT was therefore to be preferred over (discriminatory) income tax.

Hence, there was a staggered shift in attitude to VAT more especially during the third quarter of the 20th century. This change in sentiment produced the following practical outcome. Once there is sufficient discontent in a local economy with the existing tax system, the preferred option for tax reform is likely to be the introduction of VAT. Hence, the formula that has resulted in the internationalization of VAT is: economic theory + local discontent with tax system = VAT is introduced.

2.6 Why are there different forms of the tax?

Three distinct models of VAT have developed. They are linked to the prevalent economic model at the time the tax was adopted.

1. From 1955 to the early 1970s - when economic theory stated that income tax was no longer superior to VAT - the tax was introduced in France and spread in Europe, South America and Africa. As envisaged by economists, the tax was almost invariably a multi-rate, multi-exemption model ("variation 1").
2. From the mid 1970s to the present day, countries adopting the tax usually opted for a single rate/widespread exemption model ("variation 2"). The change to single rate partially conformed to the new preferred model under economic theory - the single rate/minimal exemption variation. Some countries which had adopted "model one" of the tax during the prior period now upgraded to "model two"; most noticeable here being the EU's ongoing efforts to achieve a single rate for all of its members' VAT regimes.
3. In 1986, New Zealand introduced a single rate/limited exemption model along the lines favored by economists. The main exemptions here being financial services, residential rent, and exported goods and services. It coined the term "GST" (goods and services tax) to differentiate this variation from earlier models.

Many countries after 1986 studied the New Zealand "GST" model and intended to introduce it (e.g., Canada, Singapore, South Africa and Thailand). However, political and equitable considerations resulted in them adopting further mainstream exemptions education, health, and food being common examples. They therefore actually ended up with a single rate/widespread exemption tax ("model 2"). One very minor consequence of this was that some of the countries called their tax "GST", thereby ensuring that the phrases "VAT" and "GST" became interchangeable and of little practical distinction.

To summarize:

Three types of VAT regimes now exist:

- Multiple rates/multiple exemptions
- Single rate/widespread exemptions
- Single rate/limited exemptions.

While economic theory now advocates the last-mentioned model, political and equitable realities usually ensure the adoption of the single rate/widespread exemptions structure.

2.7 Will the internationalization of VAT continue, stop, or contract?

Economic theory still favors VAT. Moreover, the trend towards a single world economy arguably encourages other countries to adopt the tax. It is therefore likely that the spread of VAT will continue.

Certainly, there is little prospect of a widespread repeal of VAT. A VAT regime, once introduced, rapidly becomes an ingrained part of the tax system and raises significant Government revenue (typically 15-25%). While public reaction to the introduction of the tax varies markedly from country to country, no VAT regime has ever been repealed. This applies even when the new tax has been subjected to sustained hostility (e.g., Canada). The longevity of VAT therefore seems to be as assured in the 21st century as is the existence of taxation.

3. The VAT Regime in Ethiopia

3.1 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))

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))

A taxable activity 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))

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))

For the purpose of the VAT proclamation “person” means any natural person, sole proprietor, body, joint venture, or association of persons. (Article 2(11))

Article 2 (15) of the Proclamation, which deals with definition, states that “Resident person” shall have the meaning given to it under the Income Tax Proclamation.

The new Income Tax law of Ethiopia Proclamation No 286/2002 defines and/or outlines who and what constitutes a resident in Ethiopia.

Article 5 defines and outlines the principle of residence. Accordingly under Article 5 (1) (a)-(b) an individual shall be resident in Ethiopia. If he:

- a. Has a domicile within Ethiopia;
- b. Has a habitual abode in Ethiopia; and or
- c. Is a citizen of Ethiopia and a consular, diplomatic or similar official of Ethiopia posted abroad.

Pursuant to article 5 (2) an individual, who stays in Ethiopia for more than 183 days in a period of twelve (12) calendar months, either continuously or intermittently, shall be resident for the entire tax period.

With regards to a body, pursuant to Article 5 (3), a body shall be resident in Ethiopia, if it;

- a. Has its principal office in Ethiopia;
- b. Has its place of effective management in Ethiopia and/or
- c. Is registered in the trade register of the Ministry of Trade and Industry

It should be noted that according to Article 5(4) “Resident person” includes a permanent establishment of a non-resident person in Ethiopia.

3.2 VAT Rate

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

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.

3.3 Registration

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 persons.

3.4 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.

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))

By virtue of Article 8(4), the Minister of Finance and Economic Development may by directive exempt other goods and services. In a similar manner Income Tax Proclamation No 286/2002, Article 13 (e) has empowered the Council of Ministers and the Minister of Finance and Economic Development to exempt by regulation any income for economic, administrative or social reasons.

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.

The Council Ministers for the proper interpretation of the VAT proclamation issued the Value-Added Regulation No 79/2002.

The major areas on which proper and broader interpretation has been rendered include exemptions granted by the VAT proclamation whereby general areas of exemptions have been listed without detailed interpretation and implementation terms and conditions. In this regard, the regulation clearly states what falls under the exempted items and what does not fall under or constitute exemption under the VAT proclamation. These exemptions include inter-alia provision relating to religious or church-related services and provisions relating to supplies of humanitarian aid.

The Regulation provides that generally, services rendered by a religious organization that are integral to the practice of that religion come within the exemption. The donation in

kind or money (such as church plate donation) or services is not subject to tax if there is no direct link between the payment and any benefit received by the donor. (Article 23 (1), (2), (4) and (6))

However, the activities of a religious organization that compete with the private sector or that are not integral to the practice of the religion do not come within the exemption. In which case if the value of these taxable supplies exceed the threshold of 500, 000 Birr, the religious organization must register. A religious organization that operates taxable activities through a development commission or similar entity must separately register the commission or the similar entity.

The Regulation also provides that the exemption for supplies of humanitarian aid applies to goods imported or purchased locally by organizations registered as humanitarian organizations for such purpose. (Article 26 (1) and (2))

The exemption covers the import of goods or purchase of goods locally with an announcement or declaration of a natural disaster, industrial accidents, or catastrophe by the Disaster and Prevention Commission.

The Regulation contains a provision that deals with import exempt by law or agreement. An exemption by agreement covers tax exemption for certain import of goods only if the agreement is entered into by the government or the agreement is entered into with permission granted by the government. (Article 28 (3) and (4))

The exemption by agreement includes exemption provided under;

- a. A technical assistance or humanitarian assistance agreement entered into between a government of any country;
- b. The Diplomatic Immunities and Privileges Convention;
- c. An International Convention having the force of law in Ethiopia; and
- d. Any other multilateral agreement to which Ethiopia is a party.

3.5 Tax Credit, Procedures For Filling Tax Return and Payment of VAT and VAT Refund or Rebate.

3.5.1 Tax Credit

Under the VAT law the amount of VAT that is creditable is the amount of VAT payable (paid) by a registered person in respect of tax invoices or customs declaration issued to the person for:

- a. Imports of goods that take place during the current accounting period; and
- b. Taxable transactions involving the supply of goods or rendering of services that are considered to take place during the current or preceding accounting period.

Where the goods or services are used or are to be used for the purpose of the registered person's taxable transactions. (Article 21(1)(a) and (b))

In cases where only a part of the supplies made by a registered person during a tax period are taxable transactions, the amount of tax credit or rebate for that period is determined;

- a. In respect of a supply or import received, which is directly allocable to making of taxable transactions, the full amount of tax payable in respect of the supply or import is allowed as credit or rebate.
- b. In respect of a supply or import received which is directly allocable to the making of exempt transaction, no amount of tax payable in respect of the supply or import shall be allowed as a credit or will be allowed as a credit.
- c. In respect of a supply or import received which is used both for the making of taxable and exempt transactions, the rule of apportionment of the credit will be determined by a directive to be issued by the Ministry of Revenue.
(Article 21 (2) (a) – (c))

Where VAT indicated in the VAT invoice or customs declaration for a transaction exceeds VAT payable on this transaction, the registered person is allowed a credit for the amount of the excess in the accounting period in which the event referred to occurred.

However if the supply was made to a person who is not a registered person, no credit will be allowed unless the excess tax has been repaid to the recipient of the supply.
(Article 21(5))

A person who registers for VAT after the introduction of VAT will be entitled to credit in the first accounting period in which the person is registered for VAT paid or payable on goods (including capital goods) that are on hand on the date of registration.

However this will be applicable only to the extent that the purchase or import of the goods occurred not more than six months prior to the date of registration. (Article 21(6))

A beneficiary of the duty draw – back scheme under proclamation No. 249/2001 - a proclamation to establish Export Trade Duty Incentive Scheme is not entitled to a refund of VAT paid on imports under the VAT credit system of the VAT law. (Article 21(7))

3.5.2 Procedures for Filing Tax Return and Payment of VAT

Under the VAT law every registered person is required to: (a) File a VAT return for each accounting period, whether or not tax is payable in respect of that period; and (b) pay the tax for every accounting period by the deadline for filing the VAT return. The VAT return for every accounting period must be filed not later than the last day of the calendar month following the accounting period. (Article 26, 1(a) and (b) and (2))

3.5.3 VAT Refund or Rebate

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 tax 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 amount. (Article 27(1))

In the cases 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 shall be refunded by the tax 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 amount. (Article 27 (2))

Where the tax authority is satisfied that a person who has made an application for refund has overpaid tax, the tax authority shall first apply the amount of the excess in reduction of any tax, levy, interest, or penalty payable by the person under the VAT proclamation, the customs proclamation, the income tax proclamation, or the sales and excise tax proclamation and then repay any amount remaining to the person if the amount to be refunded is more than 50 Birr. (Article 27 (5) (1) (a) and (b))

If a registered person is entitled to a refund and the tax authority is satisfied that the person has overpaid tax, than if the tax authority does not pay the refund within the specified two months period, the tax 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. (Article 27(6))

3.6 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 or an imprisonment of up to 15 years.

3.7 The Implication of VAT on NGOs in Ethiopia

NGOs are exempt from charging VAT i.e. they are not registered to collect VAT as they are not working for profit. This means that whenever they provide services, they are not expected to include VAT charges.

However, they are expected to pay VAT charges whenever they purchase goods and services locally although they are not working for profit and do not add value to their services.

Nonetheless, NGOs that are directly engaged in relief operations in the country have special privilege that exempts them from paying VAT, given by a directive issued by the DPPC to the VAT Department. These are a list of NGOs identified by DPPC who purchase relief aid and/or services that they buy from local markets. Other NGOs may also have that this kind of exemptions through bi-lateral or multi-lateral agreements or understandings with the government. Please note that these NGOs may implement development programs through food for work such as construction of roads, schools, health clinics etc.

Parallel to this, many other NGOs are expected to pay VAT whenever they purchase materials and services to construct the same schools, health clinics, youth centers that will be handed over to the respective line ministries or, regional bureaus for the use of communities.

3.8 The Implication of Other Taxes on NGOs in Ethiopia

3.8.1 Import Custom Duties

The Ethiopian law provides that capital goods imported by NGOs would enter into the country free of duty on the basis of project approved by the Federal Government or Regional Government organs. Privileges granted by the Federal Government organizations to NGOs are binding upon and enforceable in various regions of the country, as project agreement concluded at the national level would encompass or benefit two or more regions. On the other hand privileges granted by regions will be enforceable only within the limits of their geographical boundaries.

NGOs are exempted from customs duties on imported capital goods, upon ascertainment by the Investment Authority that;

- The goods are related to projects; and
- Qualify for customs duties exemption under the investment law after examination of project documents submitted to it by the appropriate Federal Agency or Regional Government Bureau.

The Disaster Prevention Preparedness Commission pays, through budgetary allocation, customs duties on foodstuff, medical equipment and similar other supplies imported by NGOs in response to an emergency relief call made by it.

With the exception of capital goods included in approved projects, NGOs are paying customs duties on other imported goods or services that are used to run their office and further their humanitarian and development work.

The Problem with Import Customs Duties is that NGOs are paying customs duties on imported goods other than the ones included in approved projects. Imported goods for office use and related activities are all taxable like commodities of the private business sector. This discourages NGOs and donor partners that are willing to assist and support various programs in the country.

3.8.2 Income Tax Exemption

Quite a number of NGOs are engaged in income - generating schemes through the following activities:

- a. Economic activity to enhance sustainability of the development program,
- b. Project related activity which produces some income incidentally in the course of the project implementation,
- c. Collection of fees to recover a portion of total costs, and
- d. Fund-raising event organized to collect public donation. (Surprisingly, in Ethiopia, individuals or groups of people who organize fund - raising events for self -serving purpose are not taxable.)

3.8.2.1 Income Tax Exemption from Income Generating Activities and Donations

The draft NGO Proclamation recognizes the need and provides for an association or NGO to engage in income generating activities with a view to plough back the income generated to expand the activities envisaged in its memorandum of association.

In this regard Article 55 (1) of the draft states that, "to realize its objective any organization may engage in income generating activity related to its mission or to the organization".

It also states, in Article 55 (2) that "before engaging in income generating activity an organization shall ensure that the activity will not hamper the mission of the organization or damage the interest of the beneficiaries".

It should be noted however; in order to avoid abuse and market distortions, the practice in this regard of many countries is to limit the amount of income that can be generated by such activities. Normally the amount permitted does not exceed one - third of the total income of the concerned NGO.

Article 55 (3) of the draft states that relevant laws shall be applicable to an organization engaged in income generating activity. The "relevant laws" referred to in this draft provision can relate to Income Tax Proclamation No 286/2002 whereby NGOs can be taxed on income derived from income generating activities just like any other business or for profit organization.

In this context, "relevant law" can also relate to the commercial code of Ethiopia. It can also relate to the labor Proclamation No 42/93 as amended by Proclamation No 377/2003.

The issue of income generating activities is an unsettled issue that needs further study and follow up as the draft NGO legislation is still at a preparatory stage and we don't know what the details and content of this key provision will be.

Apart from critical issues of tax exemption on income from income generating activities that need to be addressed, there are other equally important legal issues that need to be revised in order to conform with these new developments.

In this connection a case in point is Article 25 of the Commercial code which states that associations or NGOs can not carry on any trade and if they are found to be in violation of this cardinal principle it can constitute a ground for dissolution of the NGO in accordance with Article 461 of the Civil Code of Ethiopia

However, it should also be noted that the inclusion of such a provision in the draft NGO legislation is commendable and a welcomed change as far as current developments in Ethiopia are concerned.

In a similar vein, the draft proclamation has also made provision for income tax exemption. This article will also be welcome change to the existing laws and practice.

With regards to income generating activities, Article 55(1) of the draft proclamation states that "to realize its objectives any organization may engage in income generating activity related to its mission or to the organization".

In this regard, Article 56 (1) states, "any organization shall be exempted from income tax on donation it receives".

Further more, Article 56 (2) states "an individual who donates money to any organization shall be granted deduction according to the amount of money he donated for income tax purpose". In other words donors will be entitled to income tax deductions with respect to donations made to NGOs.

In this connection, it should be noted that the Income Tax Law of Ethiopia, Article 21 (2) states that the council of Ministers may by regulation allow donations or gifts provided for public use to be deducted.

In order to create enabling tax environment, NGOs had and are still recommending that;

- a. NGOs should be exempted from income tax on the net profit earned from their economic activities, where such activities do not constitute the principal purpose or activity of the organizations.
- b. NGO activities, run on a fee basis as cost recovery, should not be taxed on the ground that there is no net revenue generated by these activities.
- c. NGOs should be exempted from income tax on the profit made from income generation activities, where such revenue is not used for self - serving purposes but used as plough back to the NGO humanitarian and community development program and projects.
- d. Income raised by indigenous NGOs through local fund - raising events such as bazaars, sport and other entertainment events or bake sale should not be subject to taxation, since the net income represents the free donation of the public to the cause the events are organized for.
- e. Donors should be entitled to income tax deductions with respect to donations made to NGOs.
- f. Income - generating activities supported by NGOs but owned by beneficiaries should be taxed as any other business venture, as they are self - serving in nature.

3.8.2.2 Income Tax Exemption of INGO International Staff

Under the new Income Tax Law of Ethiopia, salaries and benefits of international staff is subjected to income tax. Most INGO international staff contracts assume no payment of income tax in the country of operation.

The new Income Tax Law provides also for exceptions to the general rule. Accordingly the tax law provides for exemption from tax based on international law, customs and usage – comity, treaty or bilateral agreements.

Ethiopia has through out the years granted privileges and exemptions from taxation based on economic, social and public interest policy considerations. Tax exemptions granted to promote investment and economic development is a case in point.

The precedence of granting tax exemptions has been in place for more than four decades. This has been done on a selective and on a case – by – case basis.

Should INGOs international or expatriate staff be granted income tax exemption? What are the arguments that can be forwarded in favor of granting exemption?

The case at hand and the mix of the problem can be categorized and presented in ten points, which are all complementary, and collectively they do not only present the case clearly, but also offer a persuasive and compelling argument that needs all the serious consideration that it duly deserves and these are:

1. Most INGO international staff contracts assume no payment of income tax in country of operation.
2. Income tax is often already deducted in the home country of international staff.
3. Collecting taxes from employees whose payroll is administered in the INGO's home office would be expensive and complex to administer.
4. As charitable organizations, many INGOs receive funds exempted from taxation.
5. Many INGOs deliberately maintain a small number of international staff who bring into Ethiopia new program development ideas from their experience in other countries and help to facilitate the personal and professional development of local employees.
6. We need the international staff to solicit further funding and maintain the cycle of funding in the future. They are a link between INGO programs and donors.
7. The taxing of INGOs could significantly hamper the government's efforts at poverty alleviation in rural and urban communities.
8. Most donors are reluctant to give funds that they know will be used to pay taxes on international staff salaries.
9. INGO home offices have already confirmed that they would not increase INGO budget to make up for this tax.
10. The imposition of the tax will harm INGO programs in Ethiopia by;
 - a. Reducing funds for programs, notably service delivery and capacity building in pursuit of poverty eradication or relief activities;

- b. Reducing their ability to recruit international staff for management, transfer of skills and to provide diversity and cross – learning;
- c. Reducing the number of NGOs in Ethiopia.

On the other hand it can strongly and persuasively be argued that as Ethiopian Income Tax Law is not based on nationality principle but on resident principle, for tax purpose they are considered as tax payers and must thus declare their income and pay tax and where the international staff for expatriate is paid here in Ethiopia on a payroll basis, the concerned NGO must present the payroll to the tax authority and pay income tax.

What is the way out? One viable option is to grant income exemption of international staff or expatriates by concluding an agreement with the Ministry of Finance and Economic Development i.e. a bilateral agreement to be concluded between the concerned NGO or by the donor government and the competent authorities of Ethiopia.

Pursuant to Article 53 of the Ethiopia Income Tax law, NGOs have the obligation to withhold income tax on payments, which are subjected to withholding tax.

The amount to be withheld is two percent (2%) of the gross amount of the payment.

Within ten days from the last day of each month, the concerned NGO must transfer to the Tax Authorities the amount required to be withheld on payments made during the month.

If the NGO fails to withhold or under withholds it shall be made to pay the full amount of the tax to the Tax Authority.(Article 53 (1), (2) and (51))

Under Tax withholding scheme Application Council of Ministers Regulation No 75/2001, NGOs collect withholding tax from taxpayers who provide a wide range of services and goods.

This includes consultancy service, designs, written materials, lectures and dissemination of information service, legal, accounting, auditing and other similar services, advertisement service, maintenance services, construction services rent or lease of equipment building and other goods and supply of goods involving more than Birr 10,000 (Ten thousand) in any one transaction. (Article 2 (1) - (11))

Pursuant to Article 8 of the Income Tax Law, which deals with schedules of income, rendering of technical services falls under schedule "o".

In this regard, Article 32 of the Income Tax Law provides that all payments made in consideration of any kind of technical service rendered outside Ethiopia to a resident person in any form shall be liable to tax at a flat rate of ten percent (10%), which shall be withheld and paid to the Tax Authority by the payer. The term "technical service" means any kind of expert advice or technological service rendered. (Article 32 (1) and (2))

Under Article 23 of the Value - Added Tax Proclamation, if a non resident person who is not registered for VAT or any resident legal person, the rendering of services is taxed according to Article 23 which deals with reverse taxation.

Under Article 54 of the Income Tax Law of Ethiopia, NGOs have the obligation to withhold ten percent (10%) from the payment made to expatriates who have rendered technical service to the NGO. The obligation of the NGO to withhold such tax has priority over all other obligations to withhold amount from payment to the payer or the service provider. Such payments must be made with fifteen (15%) days of the end of each calendar month. (Article 54(1), (2) and (3))

3.9 Others

3.9.1 Stamp Duties

The law on the payment of stamp duties, Stamp Duty Proclamation No 110/98, subjects all associations or NGOs to the payment of stamp duties on their memorandum and articles of associations; on contracts whenever they lease or sub -lease property or when they transfer their lease rights to third parties; and when they register title to their property.

Though payment of stamp duties is law and does not occur on a regular basis as other taxes such as income and VAT for example, exemption in this area is not a critical issue. However the government may grant exemption to NGOs also in this area as a gesture of offering beneficial tax treatment with the view of supporting and encouraging the sector.

3.9.2 Lease Free Land Grant

The lease free land grant to NGOs and churches was a valuable incentive. However, the administrative provisions and their cumbersome requisites and formalities are found to be prohibitive by NGOs.

In practice, NGOs and churches are granted the privilege to acquire lease free land for their religious, humanitarian and development activities.

However, as of late, the issue of land acquisition lease free has become a very difficult task and even in the case of land lease fee, the price is exorbitant and NGOs cannot compete with the private sector and bid for land at every high and exaggerated price and rate.

In light of this development, it is therefore recommended that lease free land grant should be automatic for humanitarian and development work benefiting communities in need and in cases where this is not possible or feasible, NGOs should be granted lease land at a very low and nominal rate.

4. International Experience and Best Practice on VAT and VAT Exemption for NGOs

This section presents a survey of the VAT regimes in various countries across the globe with particular emphasis on NGOs.

The survey is intended to indicate and illustrate international experience and best practice regarding VAT.

It covers a wide geographic area. Included in the survey are African, Asian Newly Independent States, European Union, Eastern and Central European Countries and North American Countries.

4.1 Africa

Since the introduction of VAT in many African countries, governments have been and are still granting public benefit organizations or NGO VAT exemption.

The key test in most cases is the fact that the beneficiary organization must be engaged not for profit activity dealing mainly with public interest issues that the governments of the day give priority to.

These include in most cases education, religious services or scientific research, as is the case favorable in South Africa and Kenya.

In some African countries, NGOs are offered VAT exemption as per the VAT law of the land where by the beneficiaries and the specific area or categories of exemption are specifically listed.

Accordingly there will be those that will be exempted total or zero-rated by way of example we can cite Ethiopia, South Africa, Namibia, Tanzania and Senegal.

Some African countries address the issue of tax exemption under an agreement that is concluded between the beneficiary and the government. In which case the exemption is predicated on the fact that the exemption is being granted because "it is in the public interest to do so" and the beneficiary or organization must be of a "public character". A very good example for such practice is to be found in Uganda and Rwanda.

Though there are three types of VAT regimes in the world today, multiple rates/multiple exemptions, single rate/limited exemptions, most African countries follow the later practice.

For example in Ethiopia we have a single rate of 15% and a limited categories of exemptions. However, the VAT rate - the single rate varies from country to country. In

South Africa, it is 14%. In Kenya, it is 18%. In Tanzania, it is 20%. In Namibia it is 15% and in Senegal it is 18%.

By way of illustration as to how the system works, we will consider in further detail the practice in South Africa, Kenya, Uganda, Tanzania and Rwanda.

4.1.1 South Africa

Currently set at 14%, Value Added Tax (VAT) is included in the price of most goods and services. Foreign visitors are not exempt for paying VAT on purchased goods. They may, however, claim back VAT paid on items taken out of the country when the total valued exceeds R250. The refund may be claimed at the airport of departure, at various harbors and at customs offices.

The standard rate is 14%. The reduced rate varies between 0% -14%.

Importation of Goods Donated to South African Organizations is granted VAT exemption. Paragraph 5 of Part A of the First Schedule of the Value-Added Tax Act, 1991 provides for an exemption from VAT on importation of goods forwarded unsolicited and free of charge to:

- a. A public authority or local authority; or
- b. Any association not for gain which satisfies the Commissioner that such goods will be used by the association exclusively:
 - i. For education, religious or welfare purposes; or
 - ii. For the furtherance of that association's objectives directed to the provision of educational, medical or welfare services or medical or scientific research; or
 - iii. For issue to or treatment of indigent persons, free of charge.

In order to determine whether or not the exemption is applicable, the recipient of the donation should furnish the South African Revenue Service with the following:

- A letter from the donor confirming that the goods were donated.
- A letter from the recipient organization confirming the donation, stating the goods will not be sold and how the goods will be used.
- Copies of the relevant shipping documentation (Post Office advice, Air Waybill or Bill of Transport Lading)
- A copy of the import permit issued by the Department of Trade and Industry (if second-hand goods):
- A description of the goods, the volume and mass and the estimated commercial value thereof for statistical purposes.

4.1.2 Kenya

Tax exemptions available for NGOs exempt non-governmental organizations from taxation. The conditionality that an NGO must fulfill before it is exempt from income tax. These conditions state as follows: -

- The organizations, institutions, body of persons or irrevocable trusts must be of public character established solely for the relief of poverty or distress of public or for the advancement of religion or education.
- The organization so established must expend its income in Kenya or in circumstances, which result to the benefit of residents in Kenya.
- Exemptions for customs, excise and VAT is reviewed annually by the minister through amendments proposed in the Finance Bill.

Value Added tax (VAT)

VAT is charged on the supply of goods and services in the ordinary course of furtherance of a business. Import of goods and services are also subject to VAT.

VAT is a broad based consumption tax that is based on the same principles as the VAT system in Europe. The model rate is 18% of the cost of goods purchased and services rendered.

Under the VAT act, the minister for finance has powers to grant remission of tax where “it is in the public interest to do so”

In relation to NGOs, remission of VAT applies in respect of “such other goods including motor vehicles and computers (excluding passenger motor vehicles of greater than 3000 cc or four wheel drive vehicles greater 4000 cc, building materials, spare parts, edible vegetable fats and oils, office furniture and other equipment, stationary, textiles, new and used clothing and footwear, maize, wheat, sugar, milk and rice) donated or purchased for donation by any person to not-profit making organizations or institutions approved by the government, for their official use in medical treatment, education, religious or rehabilitation work or other government approved projects.

The Finance Bill 2002 recently in parliament proposed to amend the Act such that remission of VAT shall only apply in respect of official aid funded projects where the agreement in respect thereof between the government and the Aid Agency is entered prior to 1st January, 2003. In effect, any new commitments from 1st January 2003 will not be entitled to remissions of duty and VAT. This bill was approved by parliament and signed by the President on 24th October to become law.

Conditions for tax exemptions have been predicated on terms like “where it is in the public interest to do so” and institutions of “public character”. The interpretations of these terms on the various applications for exemptions made are very diverse, hence one

is at the mercy and discretion of the officials in defining such terms. This leads to selective and sometimes biased application of law.

4.1.3 Uganda

The government of Uganda has specifically provided that no tax –free status will be granted unless the organization concludes an agreement with the government showing what the organization was going to do and showing what the government was going to do for the organization as some sort of consideration.

The nature of activities of non-governmental organizations exempts these organizations from various taxes. However, this does not extend to individual employees of the organizations. Income tax is levied on income and is charged for each year of income upon all the income of persons whether resident or non-resident which accrued or was derived from Uganda.

There are no tax exemptions in Uganda. However, the Minister of Finance may exempt.

4.1.4 Tanzania

NGOs are not taxed on the activities undertaken. However, the present narrow exemptions discriminate against important NGO activities such as social and economic development and environment protection. Donated goods are exempt from import taxes and duties.

VAT was introduced in Tanzania on 1st July '98 at the rate of 20%. Essential Drugs were given exemption. Unfortunately, the essential drugs list is not up to date; so many more drugs were not covered. It seems there was no dialogue between Tanzania Revenue Authority and Ministry of Health. There were many meetings between the importers and the government. before the problem got sorted out.

Anyway, now all drugs and medical items seem to be VAT exempt. As far as other borderline items go e.g. disinfectants, VAT is payable, unless of course, the hospital institution is exempt from paying VAT.

4.1.5 Rwanda

Granting tax exemption is based on Article 78 of the Rwandan Constitution of 10th June 1991. The requirements of NGOs to qualify for special treatment or exemptions state that, the NGO in question must reach an agreement with the government and specifications must be stressed on the domain of exemptions. There are no serious impediments in getting the necessary approvals. It is more of a question of expressing how the NGO will have positive results in the line ministry that it will be working within.

If there is a convention between the government and a specific NGO then the expatriates employed in that NGO are automatically exempted from various taxes. However this does not apply to the local staff, who are taxed in accordance with the tax laws applicable to all citizens working in the country.

4.2 Asia

In Bangladesh, Indonesia, the Philippines, and Thailand, NGOs receive no exemption from VAT, but in some cases they benefit from lower rates levied on primary, unprocessed agricultural products.

In Sri Lanka and The Philippines exemption from customs duties and the VAT on donations from foreign sources can be obtained only if the donations are consigned to the relevant government agency. This procedure generally involves numerous bureaucratic obstacles and conditionally provisions.

4.3 Newly Independent States

All countries in the Newly Independent States region impose a Value- Added Tax upon the sale or transfer of goods and services including imported goods. None of the countries exempt NGOs per se from VAT. However, in most countries the majority of NGOs fall under the registration threshold for VAT. For example in Ukraine the threshold is \$11,500 for twelve consecutive months while in Georgia the threshold is \$14,000. An NGO that does not register need not collect and pay VAT on goods and services that it provides and thus does not incur compliance costs (*i.e.*, for accounting and reporting). Unfortunately, it is unable to obtain rebates for the VAT that it pays for goods and services. As a result, this is not an approach that is particularly beneficial to NGOs.

Another option is to “zero-rate” goods and services. Under this option, an NGO must pay the VAT on goods and services that it purchases, but it may seek rebates for those amounts. This is generally considered a preferable option for NGOs. NGOs in Georgia, in Azerbaijan (for supplies under grants agreements), and in Armenia (for supplies under charitable humanitarian aid agreements), are eligible for a VAT rebate, the equivalent of a zero rate.

The most common approach taken in the region, however, is not to exempt any particular type of organization, but instead to exempt transactions in certain goods and services. The VAT laws in each of the countries in this category contain a list of the types of goods and services that are exempt, and the list varies from country to country. For example, in Ukraine, charitable aid or free of charge transfers of goods and services to NGOs listed in the Registry are exempt from VAT, as are other transactions listed in the law.

The VAT rate also varies from country to country. For example, in Armenia, the standard rate is 20% and a zero-rating applies to certain international transactions only. There is no reduced rate.

In Azerbaijan, there is a uniform rate of 18% and zero-rating is applicable only for foreign grants while as in Belarus the base rate is 20% and there is also a reduced or decreased rate of 10% and zero-rating applies to export of goods, as in the case in Ethiopia.

In Georgia, the standard rate is 20% with no reduced rate. However, a zero-rated applies for exports, services and supplies related to international air transportation as in the case in Ethiopia.

In Kazakhstan, the standard rate was 16%. However, effective as of January 2004, it has been reduced to 15% to be more in like with the providing rate in international practice. There is no reduced rate but zero-rating applies on the exports.

In Kyrgyz Stan, the standard rate is 20%. There is no preferential rate and zero rating applies for exports.

In Moldova, the standard rate is 20% and there is a reduced or decreased rate of 51%. As all other countries in the region, zero-rate applies to exported goods.

In Russia, the standard rate is 20% and the reduced rate is 10% while in Tajikistan, the base rate is 20% with no reduced rate. However, there is a zero-rated for exports.

In a similar manner, Turkmenistan, Ukraine and Uzbekistan have a standard rate of 20% with no reduced rate but with a zero-rated for exports.

By way of illustration as to how the system works, we will consider in further detail the practice in Armenia, Kazakhstan, Kyrgyz Stan, Tajikistan and Ukraine, which shed some light on the treatment of NGOs and VAT exemption.

4.3.1 Armenia

Armenia provides few VAT exemptions for specific kinds of persons or organizations, other than those privileges granted by international treaties or agreements. However, NGOs may enjoy VAT privileges with regards to goods imported by them from abroad, or acquired in Armenia, if used within the framework of "humanitarian assistance and charity programs" under the procedure specified in certain government regulations and the budget legislation.

Under these programs, VAT becomes reimbursable when (and only when) the government elects to "co-finance" a humanitarian or a charitable program. To receive the reimbursement, an organization must obtain humanitarian or charitable status by applying to the Central Commission on Humanitarian Assistance (which provides reductions on customs duties and other fees).

Upon approval of a humanitarian or charitable program by the Central Commission and procurement of government "co-financing," the initiator of the program must obtain a "voucher" for each transaction (for both import operations or domestic acquisition) from the Ministry of Finances, which is subsequently tendered to the customs authorities or to the domestic supplier in lieu of VAT payment.

4.3.2 Kazakhstan

Until January 1, 2004, associations of disabled persons and production organizations enjoy exemptions from VAT on supplies of goods, works, and services, so long as they satisfy the following conditions:

- a. At least 51 percent of the employees of the organization must be handicapped; and
- b. Wages paid to the disabled employees must comprise no less than 51 percent of the organization's overall payroll (this number is further reduced to 35 percent for specialized organizations employing hearing-speech-, or vision-impaired workers).

Turnover of the supply of services by NCOs is exempt from VAT, if related to:

- a. The provision of services for protection and social welfare of children, the elderly,
- b. War and labor veterans, and disabled persons; and religious sermons and the sale of religious goods by religious organizations.

4.3.3 Kyrgyz Stan

Section 145 of the Tax Code ("Supplies Provided by Non-commercial Organizations") provides for exemption from VAT for several categories of goods and services when

provided by certain types of taxpayers. Supplies provided for payment that does not exceed the cost of such supplies is exempt from VAT, if:

- a. They are supplies of goods, works, and services provided by non-commercial organizations for healthcare, education, science, culture, and sports establishments;
- b. They are supplies of goods, works, and services provided by non-commercial organizations for social security or the protection of children or low-income elderly;
- c. They are supplies of services provided by healthcare, education, science, culture, and sports institutions;
- d. They are supplies of religious services by religious organizations;
- e. They are supplies of specialized goods for disabled;
- f. They are supplies by charitable organizations for charitable purposes.

Section 145 thus exempts certain socially beneficial supplies from VAT, upon condition that such goods and services are supplied at or below cost, and so long as the supplier is a non-commercial organization, such VAT exemption is applicable only to charitable organizations.

The following supplies that may be of interest to NGOs are exempt from VAT:

- a. Supply of residential buildings or renting out of residential premises, with certain exceptions;
- b. Supply of pharmaceuticals;
- c. Financial services enumerated by the Tax Code;
- d. Insurance service and services concerned with payment of pensions.

The import of the following goods of interest to the NGO community is exempt from VAT:

- a. Goods provided for rendering assistance when liquidating consequences of natural calamities, armed conflicts and accidents;
- b. Goods imported as humanitarian assistance, grants under the procedure established by the Government of the Kyrgyz Republic;
- c. Pharmaceuticals in accordance with the list approved by the Government of the Kyrgyz Republic;
- d. Educational materials and school accessories, scientific publications;
- e. Baby food.

The abovementioned exemptions for imports are conditioned upon compliance with customs regulations. The VAT exemption also applies to imports designated in the customs regulations.

4.3.4 Tajikistan

Supplies of goods, works and services by associations of the disabled, blind and deaf, as well as enterprises owned by such associations, are exempt from VAT, provided that two conditions are met: (i) the disabled, blind, and/or deaf constitute no less than 50 percent of their employees; and (ii) no less than 50 percent of the overall remuneration (including such in kind) is allocated to the disabled, blind, and deaf.

Otherwise, VAT exemptions are based on the type of operation or import rather than the type of organization, although their application may be conditioned on certain characteristics of the organization.

4.3.5 Ukraine

Sales or transfers of goods or services are generally subject to VAT based on their actual Value. As an exception to this rule, VAT is not levied on charitable aid or on free-of-charge transfers of goods or services to charitable organizations, other organizations listed in the NPO Registry, state or municipal authorities, state or locally owned organizations, institutions, or enterprises. In addition, VAT is not levied on the free transfer of goods or services to beneficiaries of charitable aid recognized as such by law.

The Law on Humanitarian Aid specifies the procedures for labeling and distributing charitable (humanitarian) aid, as well as for control over the provision of humanitarian services.

In accordance with this law, if charitable (humanitarian), aid is received from a foreign legal or natural person, the recipient of such aid must be accredited by the Commission on Humanitarian Aid to receive exemptions from the VAT and other taxes.

4.4 Central and Eastern European Countries

The International Center for Not-for-profit Law (ICNL) recently commissioned a survey of tax laws and regulations affecting non-governmental organizations in thirteen countries in Central and Eastern Europe.

The fourteen countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Lithuania, Latvia, Macedonia, Poland, Romania, Slovakia and Yugoslavia.

Of interest here and to our study, is the VAT regime in these countries.

All countries in Central and Eastern Europe impose a value added or similar tax upon the sale or transfer of goods and services. The treatment for NGOs under VAT regimes

varies widely. Even within a single country, different types of NGOs may find themselves subject to different treatment for purposes of VAT. All countries in the region have a monetary threshold below which an organization need not register for inclusion in the VAT system.

Several countries in the CEE region take the approach of exempting either all or some NGOs from the VAT system. The exemption is generally limited to the extent that either

- a) The NGO engages in activities other than public benefit activities, or
- b) The NGO engages in commercial activities.

Countries in this category include Romania, Slovakia, and the Czech Republic. Croatia exempts from VAT religious organizations and the Red Cross, as well as political parties, trade unions, trade chambers, and most domestic humanitarian organizations. It has also recently enacted amendments to its VAT law providing for a “tax holiday” or exemption, for not-for-profit organizations that receive foreign donations of goods or services, as well as for in-country purchases financed by foreign financial aid. The amendments also provide an exemption for independent artists and artistic organizations.

Macedonia does not as a general matter exempt NGOs, but cultural organizations, botanical gardens, zoos, parks, archives, and documentation centers are exempt.

Estonia has very limited exemptions from VAT; goods not subject to excise tax received by NGOs are exempt from import VAT if they are received as state foreign aid or purchased with money received as state foreign aid, or granted as state foreign loans.

Hungary permits taxpayers with less than actual or expected annual income of 2 million HUF (approximately \$7000 US) from economic activities to elect tax-exempt status. The rationale behind this provision is that an organization with little income will bear a disproportionate administrative burden in complying with the law.

The most common approach taken in the region, however, is not to exempt any particular type of organization, but instead to exempt transactions in certain goods and services. The VAT laws in each of the countries in this category contain a list of the types of goods and services that are exempt, and the list varies from country to country.

In Albania, for example, donated food or medical services benefiting NGOs are exempt from VAT, as long as these goods are not resold.

In Bulgaria, donations to NGOs are exempt from VAT; certain transactions are exempt, as are import transactions relating to certain foreign aid.

In Croatia, international humanitarian organizations are entitled to an exemption for goods and services purchased for official use and for private staff use if there is an agreement between the organization and the government.

Lithuania exempts goods imported as charity from import VAT.

In Macedonia, gifts by foreign donors to public institutions and registered Macedonian humanitarian organizations are exempt.

Poland's VAT law contains a list of goods and services that are exempt, including education, health protection, and social welfare.

Hungary and Latvia also exempt goods and services provided for specified public purposes.

Zero and preferential rates are infrequently used in the region. Hungary and Poland use zero or preferential rates to reduce the amount of VAT collected and owed on transfers of certain goods and services. These rates are not imposed specifically on goods or services provided by NGOs.

However, some of the goods or services subject to lower VAT rates are among those likely to be provided by NGOs (e.g., education, health, welfare services).

Poland applies a 7 percent preferential rate to many goods and services, including hearing aids, pharmaceutical products, certain medical and sanitary articles, rehabilitation products, and Braille devices.

Hungary zero-rates pharmaceuticals, books for public education, and products for the blind, and affords a preferential rate of 12 percent to, e.g., certain medical and pharmaceutical products, book, newspaper, and magazine publishing, performing arts, library services, professional sports, and zoological and botanical parks.

Croatia applies a zero-rated to scientific journals.

Macedonia gives a preferential rate of 5 percent for the publication of brochures and periodicals.

Yugoslavia and Bosnia & Herzegovina employ turnover taxes as opposed to VAT. These are older style taxes, which have now been eliminated in most countries of the region in favor of value added taxes.

In Montenegro, NGOs are exempt from turnover taxes on goods as long as they are for the organizations' statutory activities.

In Serbia, the rule is the same, except that it specifically exempts goods imported for aid by the Red Cross and domestic goods donated to the Red Cross.

In Bosnia & Herzegovina, the Red Cross and other humanitarian organizations, as well as religious organizations are exempt from turnover taxes on most goods if they are used to

pursue the organizations 'major statutory goals. In addition, services rendered by such organizations are exempt.

Summary of Central and Easter European Countries Treatment of Value Added Taxes for NGOs

Exempt organizations	Czech Republic, Estonia, Macedonia, Romania, Slovakia
Exempt transactions	Albania, Bulgaria, Croatia, Hungary, Latvia, Lithuania
Zero Rating	Croatia, Hungary, Latvia
Preferential Rates	Hungary, Poland, Macedonia
Turnover taxes	Bosnia & Herzegovina, Yugoslavia

Before we consider by way of illustration of looking into how the VAT system works in the stated CEE countries, a little discussion will be in order to briefly comment upon a very interesting practice.

The Hungarian "One plus one percent" law, which allows a rebate of taxes by the designating individual directly to an NGO or church, is being viewed with interest throughout the region.

Let us now briefly examine the VAT regime in some CEE countries.

4.4.1 Croatia

Normally, an organization is included in the VAT system if it applies for such status or if the value of its taxable deliveries exceeds 85,000 Kuna a year. The Red Cross, political parties, trade unions and chambers, religious communities and medical, cultural and other institutions established under separate laws are exempt from VAT, the rate of which is 22% on the total value of the organization 's deliveries. Domestic humanitarian organizations have the status of a final consumer and are thus not included in the VAT system. Goods necessary to accomplish statutory goals purchased by domestic organizations with donations from foreign organizations are exempt.

International humanitarian organizations do not pay VAT for goods and services purchased for official use and private use of staff if an agreement is signed with the government and may also be exempt from VAT on purchase of goods within Croatia.

New amendments to the VAT law provide for tax holidays for non-profit organizations that receive foreign donations of goods or services, as well as for in-country purchases financed by foreign aid. In addition, independent artists and artistic organizations are now exempt from the VAT system. Scientific journals are zero-rated.

4.4.2 Hungary

The VAT rate is 25% although there is a preferential rate of 12% for certain products. No taxable persons are exempt from VAT. Taxpayers whose actual and expected annual income from economic activities is less than 2,000,000 HUF may elect tax-exempt status at the outset of the tax year. Sales of certain products and services are exempt, including health care, social care, organization of scientific events, public radio and television, education, hostels and dormitories, libraries, museums, and nonprofessional sports. Zero-rating applies to exports, pharmaceuticals, books used in public education, products for the blind, and baby diapers.

4.4.3 Latvia

The VAT rate is 18% of the value of the delivery of goods, services and consumption that is subject to taxation. Exports are zero-rated. No legal persons are exempt from VAT. Certain goods and services are exempt, including those offered by pensions for the elderly, social care or rehabilitation centers, preschool fees, meals offered by prisons and reformatories, tuition and professional training fees, library services, fees for certain cultural events, and medical services.

4.4.4 Lithuanian

The VAT rate is 18%. A zero-rate applies to exported goods. No specific persons are exempt from VAT. Goods imported as charity are exempt from import VAT. Specific goods and services are exempt from VAT, including social services rendered to children or the elderly, certain medical technology, educational services provided by registered institutions of learning, certain noncommercial cultural services, cultural landmark restoration and conservation services, and certain traditional artisan work, among others.

4.4.5 Poland

The VAT rate is 22%. There are no exemptions from VAT available to specific kinds of persons. Certain goods and services are exempt, including services in the fields of

scientific, technical, and economic information, research and development, education, health protection and social welfare. Other goods and services are accorded a preferential 7% rate; these include hearing aids, pharmaceutical products, and certain types of medical and sanitary articles, rehabilitation products, and Braille devices.

4.4.6 Romania

Generally, the VAT rate is 22%. Associations are subject to VAT only if they are performing economic activities. Nonprofit organizations are exempt from VAT for all social and charitable activities; for activities in the civic, political, or religious fields; or if they are organizations for the blind and disabled or health services organizations. Trade unions and public institutions are exempt for administrative, social, educational, national defense, public order, state security, cultural, and sports activities.

Goods and services for projects on Romanian territory financed by foreign governments, international institutions and NGOs, and goods and services for projects financed by PHARE are subject to a zero rate. Certain publications are entitled to a preferential 11% rate.

4.4.7 Slovakia

The VAT rates are 10% and 23%. Legal entities not established to conduct business do not register as VAT payers. Non-business entities that conduct economic activities may become VAT payers if they have business licenses and their turnover from business activities exceeds 750,000 SK.

Activities exempted from VAT include educational, training, scientific, health care, and social care services. If goods are exempted from import duties, they are also exempted from the VAT. Also, if the following goods are received from abroad, they are exempt from taxation: goods for education, scientific and cultural purposes; religious objects; and goods designated for disabled persons.

4.5 European Union Countries

All EU Member States are required, as a condition of admission to the Union, to adopt VAT. While the tax rates vary from country to country, the EC 6TH VAT Directive has substantially harmonized the tax base in the Member States, and those states seeking admission to the EU will be required to adapt their VAT law as necessary to comply with the 6th Directive. The extent to which the tax base has already been harmonized within Europe limits the freedom of individual states to grant tax privileges to NGOs.

Moreover, it appears the Commission is taking the position that the candidate countries must adapt their existing laws to comply with the 6th Directive without being entitled to maintain any relief that are inconsistent with the Directive, even if those relief are compatible with derogations that have previously been granted to existing Member States.

The minimum standard rate permitted in the EU is currently 15% and the average of the rates currently in force in the Member States is 19%. In broad terms, VAT at the standard rate must be charged on all supplies of goods and services to or by NGOs unless the supplies are made in the course of non-business activities or qualify either for exemption or taxation at a reduced rate. The concept of a reduced rate includes a rate of zero, which enables an NGO to avoid charging VAT on supplies to its beneficiaries while retaining the right to recover VAT on purchases attributable to those supplies - it is sometimes called "exemption with credit".

Exemption from VAT is granted for specific supplies of goods and services rather than as a general relief for the taxpayer making the supply. The scope of the exemptions available under EC law is generally restricted to activities in the public interest, as prescribed in Article 13 of the 6th Directive. Article 13 includes the following services which NGOs may be undertaking: hospital and medical care; welfare and social security; protection of children; education; sport; culture; fund-raising; and transport services for sick or injured persons. Member States can impose conditions on the application of these exemptions.

The designers of the EC VAT system intended that reduced tax rates should be applied only for clearly defined social reasons and for the benefit of the final consumer. However, the European Court of Justice held in the infraction proceedings to limit the UK's use of zero-rating that "the provision of goods and services at a stage higher in the production or distribution chain which is nevertheless sufficiently close to the consumer to be of advantage to him must be considered to be for the benefit of the final consumer" (Commission v. UK, Case 416/85, ECR [1988] 3127).

Consequently, most NGOs providing goods and services to their beneficiaries on a wholly or partly subsidized basis can reasonably argue that the benefit of reduced rates should be extended to their supplies. However, none of the Member States operates a reduced VAT rate for all supplies by NGOs to their beneficiaries, and where such relief exist the reduced rate applies only to limited categories of supplies.

The harmonization of the tax base by the EC 6th VAT Directive allows individual states limited discretion to grant relief from VAT to NGOs. It would be possible for states to grant relief indirectly (e.g. through public expenditure by making compensatory grants or increasing existing grants to NGOs) without breaching EC law, but there is no general provision in the EC VAT laws that would allow a Member State to grant broad-based relief in the form of a direct reduction of the tax rate or the tax base other than as part of the existing framework of relief in the 6th Directive.

In some Member States it appears that some or all of the VAT costs incurred by certain NGOs (e.g. those engaged in the provision of services that are priority areas for the allocation of government expenditure, such as health and education) are effectively reimbursed by means of their annual budgets being funded by government grants disbursed by the government departments with responsibility for funding the delivery of the services concerned.

Within the structure of the tax, there are two main opportunities for states to reduce the burden:

- a. to reduce the rate of VAT applicable to goods and services purchased by NGOs; and
- b. to tax goods and services supplied by NGOs to their beneficiaries, but at a rate that is substantially below the standard VAT rate in force.

The first option benefits all NGOs, whether or not they are engaged in economic activity. The second can apply only to those NGOs engaged in economic activity; it benefits NGOs to the extent that the tax rate is sufficiently low that it is acceptable to pass on the cost to their beneficiaries, and that the purchases on which the NGO has incurred most of otherwise related to the provision of the goods and services to the beneficiaries.

5. The Rational of Tax Exemption and for Offering Beneficial Tax Treatment to NGOs

Black's Law Dictionary defines tax exemption as "freedom from burden of enforced contributions to expenses and maintenance of government".

Tax exemption means a relief from payment of taxes. Tax exemptions are generally founded on public policy reasons.

In principle they are not granted based on the favoring of particular persons at the expense of taxpayers generally; nor are they granted on the idea of lessening the burden of individual taxpayers.

They are rather based in the accomplishment of public purposes, and granted on the ground that they will benefit the public in general.

In this connection a case in point is the power granted to the Council of Ministers to allow donations or gifts provided for public use to be tax deductible as provided in article 21(2) and that of offering exemptions for economic, administrative or social reasons as provided for in article 13(e) of income tax proclamation no 286/2002.

Charitable institutions or non-profit institutions may be exempted from payment of various kinds of taxes because, inter-alia. "Governments view (non- profits) as relieving their burden and performing certain functions of government.

Another reason for allowing tax exemptions for non-profit organizations is that they lack profit motive. In other words, the purpose they are established for or the services they render are not aimed at making profit.

"Lack of profit" seems the chief test in Ethiopia at present for qualifying for tax exemption entitlement allowed to various institutions, governmental or non – governmental aid organizations or associations.

Many rationales have been offered to support beneficial tax status for nonprofit organizations. One rationale is that nonprofit organizations are entitled to beneficial tax status because they perform functions that are supportive of central values that a government wishes to encourage, or at least avoid discouraging.

A second line of argument justifies special tax advantages for nonprofit organizations on grounds that such organizations relieve governments of burdens it would otherwise have to bear. Nonprofit organizations provide "collective goods" that meet societal needs in such fields as health, education, care for the disadvantaged, or even recreation and culture, that are not likely to be met by for-profit businesses.

Tax subsidies to such private organizations can thus be seen as a way to encourage activity that helps relieve government of responsibilities and costs it would otherwise have to bear directly. The argument for tax subsidies for such activity is strengthened by

evidence that the increase in private contributions that is stimulated by such special tax advantages is greater than the loss of revenue to government, so that the subsidies are “cost effective” in stimulating the desired behavior.

Since “nonprofit organizations” do not exist primarily to earn a profit and therefore do not compute their net cost of operation, it is sometimes difficult to define what the tax base really is for such organizations, especially for income taxation. What is more, at least some portion of the income and resources of such organizations is often contributed rather than earned, complicating taxation further.

In practice, the issue of the tax treatment of nonprofit organizations really involves two distinct sub- issues:

- (a) the tax treatment of the nonprofit organizations itself; and
- (b) the tax treatment of contributions to these organizations by individuals, corporations, and others.

In the first place, if favorable tax treatment is to be accorded to nonprofit organizations, decisions have to be made about whether to provide such treatment to all types of such organizations or only certain types. There are many distinct types of such organizations—foundations, associations, trusts, corporations, etc. Such organizations serve a variety of purposes, such as public benefit and mutual benefit. Beneficial tax treatment can either be made available to all types of nonprofit organizations or reserved, in whole or in part, just for some types.

Assuming that some differentiation of tax treatment is considered appropriate, this can be done either in terms of the type of organizations or in terms of the type of purpose it serves, though in practice these may overlap.

For example, certain kinds of beneficial tax status can be reserved for organizations serving public, as opposed to mutual, purposes, or fulfilling functions considered being especially critical for national health and welfare.

Not only can different types of nonprofit organizations be treated differently for tax purposes, but also these differences can vary by the many types of tax, e.g., income taxes and consumption taxes i.e. VAT.

Quite apart from the question of whether nonprofit organizations themselves should pay taxes on all or a portion of their income or purchases is the question of how to treat the contribution made by the donors to such organizations. By permitting donors to deduct such contributions from their income, or otherwise extending beneficial tax status to them, governments can provide important incentives for donors to make contributions to nonprofit organizations.

As noted earlier, the rationale for such beneficial tax status for giving hinges on the notion that the gifts support essentially public purposes and thereby relieve government of burdens it would otherwise face. Donors contributing to such public purposes are

therefore considered to be entitled not to be taxed on the income they devote to these purposes.

Common features of VAT exemption offered by most countries surveyed relate to specific categories of goods and services.

This can be expressed in a broad category that includes the supplies of goods, works and services for health care, education, science, culture, art and sport establishments, food stuffs, published materials, transportation services postal service, and public utilities.

It is education, health, and scientific organizations that serve the public interest that are entitled to a tax preference. The officials in charge of determining eligibility for tax preferences can now test each organization seeking a tax preference by the more expansive criterion of whether it is formed primarily to serve the public interest. In other words, is it a PBO?

PBOs should be given preferential treatment under a value added tax (VAT). If an organization is excluded from a VAT system, it pays VAT on goods and services it buys from other, for the tax is built into the price it must pay (input VAT). However, since it not in the system, it cannot apply for a refund. Although exclusion from the VAT system is not desirable from a tax point of view, small NGOs might rationally prefer it in order to be relieved of compliance burdens.

The best situation for an NGO is to be included in the VAT system but to be zero-rated. This means that, though the NGO pays VAT on the goods and services it buys, it does not have to pay output VAT, and it gets back as a rebate the input VAT paid plus the amount of nay imputed VAT on goods and services it sells to others. This approach is not adopted in many countries.

The more general approach is to give PBOs a favorable VAT rate, but not a zero rate. For example, if the general rate of VAT is 20%, the special rate for PBOs might be 6-10%.

6. The Rationale of Exempting NGOs from VAT

The designers of VAT intended it to be a tax on the final consumer. In other words, a business buying goods or services would generally not suffer VAT because it could pass on the burden of the tax to its customers, either directly by charging them VAT on taxable sales or indirectly by raising its prices to cover the cost of any VAT that it had paid on purchases used to produce goods or services that were exempt from VAT. Unfortunately, this approach failed to take into account the role of NGOs in the chain of supply of goods and services.

The effect of VAT on NGOs requires a more detailed explanation. In contrast to the way in which other taxes work, the fact that an NGO is not subject to VAT or that the goods and services that it supplies to its beneficiaries are exempt from VAT does not mean that the NGO bears no VAT costs.

VAT was conceived as a tax on the final consumer of goods and services: in most cases this will be an individual member of the public buying from a retail outlet for his or her private use. Business consumers can usually pass on the VAT that they pay on their purchases of similar goods and services to their own customers so that the only costs they incur as taxpayers are the costs of recording, administering and collecting the tax from their customers for the benefit of the government.

Most forms of NGO are in a different position. The design of VAT requires that it be imposed on all forms of economic activity, whether or not for profit, but the non-profit character of an NGO's purposes limits its ability to pass on to its beneficiaries, and their ability to pay, the VAT that is charged to the NGO on its own purchases of goods and services.

Any VAT that an NGO does not pass on to its beneficiaries, whether by reason of law (because the NGO does not conduct an economic activity or because the economic activity concerned is exempt from VAT) or by choice (because its beneficiaries cannot afford to pay the extra cost) becomes a permanent cost to the NGO. Thus, an NGO that is not subject to or "exempt" from VAT will generally pay more VAT than one that is "taxable".

The burden of irrecoverable VAT costs on NGOs varies widely. Taking the non-profit sector as a whole, it is estimated that about 60% to 75% of most NGOs' operating costs are staff costs, which are not subject to VAT. However, substantial amounts of irrecoverable VAT can arise not only in large NGOs or where an NGO incurs large capital costs (e.g. on a new building or a computer system), but also if an NGO has significant operating costs that are liable to VAT

Consequently, when compared to the private sector, the VAT costs incurred by NGOs represent a higher burden in relative terms. Moreover, the burden is likely to increase merely by reason of the growth in size of the non-profit sector.

In light of the foregoing discussion, NGOs must be exempted from VAT because; in principle

- a. VAT exemption helps compensate for the constraints on capital formation that NGOs face and serves a purpose in aiding those NGOs to better serve their beneficiaries.
- b. VAT exemption is a means of subsidization for particular services such as health care and education that would otherwise have to be provided by the government thus relieving the government of burdens that it would otherwise have to bear.
- c. NGOs perform functions that are supportive of central economic and social values and objectives that the government wishes to encourage and promote.
- d. It is necessary for the government to create a better policy and working environment for NGOs and one of such policy environment can be the granting of VAT exemption for NGOs.

In more concrete terms,

- Development projects addressing the root causes of famine and drought should be identically treated by DPPC, as they are as important as relief operations.
- Development programs that address the root cause of drought and famine and alleviate poverty, for which agreements are signed with DPPC or which are recognized by DPPC have to fall in the exempt category as addressing the root causes of drought and famine is equally important.
- DPPC does exempt NGOs from other forms of taxation (including taxes on imported capital goods) for these projects. This provision should also apply for VAT.
- The system of VAT cannot collapse because of giving an exemption to the NGO Sector as it is already done for NGOs engaged in relief operation.
- The value created or generated by exempting NGOs from VAT far out ways the value of revenue to be collected from NGOs.
- NGOs should not pay VAT because they do not add value to the service they render to communities.

- As non-self serving agencies, the beneficiaries of all relief, rehabilitation and development programs implemented by NGOs are the poorest segment of communities. Thus, there is no value added by NGOs in their service to the community. Therefore, NGOs should not pay VAT on purchases of materials and services of development projects that benefit the Ethiopian public.
- VAT does not encourage donors to support the work of NGOs in Ethiopia.
- There is donor fatigue and fund raising is a challenge for local agencies and this does not create an enabling environment.
- Donor opinion on VAT must be taken into consideration
- Administrative cost of NGOs will be higher if NGOs pay 15% VAT.

The aforementioned are compelling arguments and reasons that favor granting NGOs VAT exemption or a favorable and beneficial VAT treatment.

7. The Precedence of Granting Tax Exemption in Ethiopia

There is an established practice in Ethiopia of granting tax exemption on certain taxable activities for certain categories of beneficiary.

From Imperial days to the present this practice has been carried over through the years.

A case in point is the predecessor of the current Income Tax Law proclamation No 173 of 1961 (1953 E.C.), which contained a provision for granting exemption for a special category, which is exempted from payment of income tax on employment.

Accordingly Article 18 (h) stated that this category is covered and governed by "income specifically exempted from income tax by the law in force in Ethiopia, by international treaty or by an agreement made and approved by our Minister of Finance".

Pursuant to an agreement made by the Minister of Finance a certain category of beneficiary could be granted exemption from payment of income from employment.

Such exemptions also included exemption from customs or import duties and all other taxes.

A typical example of such an agreement is the agreement concluded on October 13, 1954 between the Imperial Ethiopian Government and the Royal Swedish Government for technical assistance in the field of vocational and technological education.

Article 8 of this agreement states all fund, material and equipment of any kind which are brought into Ethiopia for the specific propose of implementations and program or project developed under this agreement shall be admitted into Ethiopia free of customs or import duties and all other taxes shall be free of currency and foreign exchanges control.

Article 9 also states that all duty approved Swedish personnel employed by the institute shall be exempt in Ethiopia from all Ethiopia income tax or other personal tax or property tax on personal property intended for their own use including customs and import duties on personal effects, equipment and supplies imported into Ethiopia for their own exclusive use.

This was a typical tax exemption, which was granted to certain categories of beneficiaries. Educational, scientific, cultural, social, developmental, mining, humanitarian, religion etc institutions have fallen under this broad category and have enjoyed tax exemption.

We find the same kind of tax exemption provision in the new Income Tax Law of Ethiopia Proclamation No 286 of 2002.

Accordingly, Article 13 (e) states, "the Council of Ministers may by regulations exempt any income recognized as such by this proclamation for economic, administrative or social reasons" (Emphasis added)

The same law, with regard to donations or gifts states under Article 12 (2) that " the Council of Ministers may, by regulation allow donations or gifts provided for public use to be deducted". (Emphasis added)

Note that the determining factor for providing tax exemption is "economic, administrative or social reason" or "public use".

Therefore the burden of convincing the government that there is an over.... or compelling economic, administrative or social reason or public good for granting tax exemption lays on the beneficiary requesting such and exemption.

In a similar manner the new Value - Added Tax Proclamation No 285 of 2002 provides for exemption for specific categories of goods and services under Article 8 (2) and the list extends from (a) - (p).

In addition to these exemptions that the government wants to specifically exempt from VAT. It has by virtue of Article 8 (4) provided that the Minister of Finance and Economic Development may by directive exempt other goods and services other than these mentioned in the VAT law.

Since the VAT law of Ethiopia is new and since the application of this provisions that can be used for tax exemption have not be tested or tried, one cannot cite any precedence whereby certain categories of organization have become beneficiary of such exemption.

It goes without saying, as one can advice from the aforementioned, the Ethiopian tax regime both Income and VAT has made provision for granting tax exemption for "good cause" and based on "public use" or a compelling "economic, administrative or social reason".

The issue at hand is not whether there is a precedence of granting tax exemptions in Ethiopia but whether the NGO community can present a clear and present, credible and compelling case that can and should warrant the granting of tax exemption by the government to this special category of organizations.

As chapter four of this paper has clearly demonstrated, the international practice and indeed the best practice of some countries is in favor of granting VAT exemption to special categories of organization such as NGOs who are mainly public benefit organizations.

Therefore, we can comfortably and convincingly summon international and best practice of countries in favor of fortifying our argument and/or case as to why NGOs should be granted VAT exemption.

In a similar vein, it should emphatically be stated, that in the exercise of seeking and being granted tax exemption, the NGO community should undergo a rigorous and indeed unrepentant soul searching to clear and exorcize its congregation from any and all malpractice and unethical behavior and/or conduct so as to make sure that when it presents itself and its case to the government, it can stand tall and look the government eye to eye on this issue which is being pursued for and in the name of a broader public interest and the over all good of the country and the people of Ethiopia.

8. Conclusion and Recommendations

In order to present a comprehensive, lucid, well thought out and cogent argument and in order to develop a clear and incisive analysis of the situation at hand, it is imperative to consider and address the following issues that needs serious consideration and close attention.

As has been hopefully demonstrated and indicated in this paper, there are a myriad of tax issues that are concern of to the NGO community in Ethiopia.

The enactment and implementation of the new Income Tax Law and VAT Law has been of grave concern to the NGO community because they harbor legitimate fears that this new development will squeeze more financial resources from their tight and meager resources. The ever shrinking and dying up of donor funding compound their financial predicament and disposition.

On the part of the government, it has made it's intention amply clear leaving no doubt as to it's top priority being the collection of "new" and "additional" revenue thereby widening and deepening it's tax base which it needs to argument its fiscal and budgetary needs.

In light of these clearly defined position, objective and needs of the non-governmental actors and government actors, it is important to prioritize the needs of the NGO community and focus on areas that are of grave concern and utmost priority.

As indicated earlier there are no clearly defined and articulated laws governing income tax of NGOs to date. The issue of import duties particularly with regards to humanitarian situations has been addressed and granted tax exemption under the VAT law. As can be attested from past experience, the government is highly responsive and sensitive towards mitigating humanitarian situation that occur from time to time. It has granted tax exemptions from imported items and has concluded bilateral agreements with concerned parties whereby tax exemptions have been granted.

With regards to income tax of international or expatriate staff of INGOs, a remedy or relief can be secured from the conclusion of an avoidance of double taxation agreement in cases where INGO expatriate staff are subjected to double taxation on the same income both in their country of origin and in the country where they are considered as a resident for tax purpose.

If and when the government is satisfied with the capacity and the expertise that INGO expatriate staff bring along with them and the benefit they offer to the public, the government can grant exemption from income of employment and other taxes by way of the conclusion of a technical cooperation agreement which is yet another alternative of granting tax exemption.

The government can also grant exemption by virtue of obligations assumed by international treaty or convention or by custom and comity.

And finally the government can grant tax exemption unilaterally by reason of “public interest” expressed and measured by an over riding economic, social, cultural or political interest it seeks to promote or protect.

The availability of the aforementioned alternatives and means of granting income tax exemption for NGOs and their international expatriate staff with regards to income from employment and other taxes, narrows down the field and area on which the most urgent tax issue of the day is to be played out. That is none other than consumption tax – VAT which has been and will remain to be a bone of contention between NGOs and the tax authorities unless addressed comprehensively and urgently on a priority basis to the mutual satisfaction of all the concerned parties and stakeholders.

This sense of urgency and the gravity of the VAT situation needs to be discussed at create length with the view of creating awareness and forging a common position, understanding and outlook which is a prerequisite for any engagement with state actors and tax authorities of the land. This task must commence at the earliest convenience.

If we can get the issue of priority out of the way and focus on the VAT regime, there are also a host of other equally important issues that we need to consider and take an in-depth look in to.

One of these issues relates to the need of providing empirical data on VAT paid to date and payable by NGOs. We need to solicit the cooperation of all NGOs who are willing and ready to furnish this vital input for articulating and building a solid foundation for requesting a favorable VAT treatment.

The required data can clearly indicate the burden that VAT has imposed on NGOs and can also indicate by way of forecast and projection, the insurmountable burden it is bound to impose on NGOs. Thus undermining their future planned activities, sustainability and violability. Indeed perhaps their very survival.

The required data could further serve as an indicator of the annual payment or amount paid by NGOs to the tax authorities by way of VAT. Which in turn can be used as an indicator of the amount of revenue the tax authorities will lose or have to forego if and when they grant exemption or beneficial tax benefit to NGOs.

It could help to weigh the amount of revenue the government can collect from NGOs against the overall input NGOs can contribute to the economic and social development of the people, which is of concern, in fact the major concern and responsibility of the government.

The said data could above all clearly and graphically demonstrate that the value created or added or generated by NGOs far out weighs the value or revenues to be collected from NGOs.

Another vital area that needs serious considerations is the question of VAT exemption options or alternatives that can be tabled for discussion.

All the options or alternatives at our disposal should be carefully examined and weighed. The pros and cons of the options need to be clearly stated and articulated in order to present a clear picture to the stakeholders and in order to facilitate and shorten the decision making process and reaching of a consensus. The options or alternative to be chosen or favored must be made credible and sellable, least of all first and foremost to the NGO community and constituency.

As indicated earlier there are various options or alternatives. The first is to be zero-rated. i.e. consider and treat all transactions of NGOs as a transaction or taxable activity coming under zero-rated transaction.

In other words, if the VAT rate is 15 percent, NGOs (and others) will collect and pay over nothing on the zero -rated goods and services that they provide. They will have to pay the 10 percent VAT tax included in the price of the goods and services they purchase, but they may seek rebates for those amounts. This is generally considered a more beneficial option for NGOs.

Being zero rated apart from conferring a special status to NGOs, by way of fiscal policy consideration it will give a clear signal to all that the government wants to protect and shelter NGOs from the VAT regime by offering them a special tax exempt category based on public interest and/or other economic administrative or social considerations.

Most importantly, it confers the opportunity of NGOs being registered as VAT payers without the obligation to pay VAT but with the opportunity to collect tax refund or rebate on imputed tax. Thereby redressing financial loss sustained by paying imputed tax and other tax refund items covered by the VAT law. Items such as office furniture and equipment purchase, vehicles purchased to transport for goods of the office, telephone bills paid for office use, fees paid to accountants, lawyers or other professionals.

In other words it means that though the NGO pays VAT for goods and services it buys, it does not have to pay out put VAT and it gets back as rebate the input VAT paid plus the amount of any inputted VAT on goods and services it sells to others.

The second option or alternative is to be granted or accorded lower VAT rate say something between 2-5%. As other countries practice attest, this system of VAT exemption is practicable by some countries and has found to offer NGOs beneficial tax treatment. However, it should be noted that it is difficult to administer such a scheme.

The third option is to exempt NGOs from the VAT system. This option ensures that NGOs do not have to collect and pay over VAT on goods and services that they provide, and they thus do not incur compliance cost (i.e. for accounting and reporting).

However, under this arrangement, they are unable to obtain rebates for the VAT that they pay for the goods and services that they purchase. In other words, unlike the zero-rate option, this does not create an opportunity for VAT registration and the collection of VAT refund or rebate. As no VAT has been paid by virtue of total exemption, there is no ground to seek and find VAT rebate opportunities. As a result, this is not an approach that is particularly beneficial to NGOs.

Another problem with this option is that as it places NGOs under a special tax-exempt category, suppliers of goods and services will be reluctant to do “business” with NGOs as such interaction and transaction offers no tax incentive to the service providers. The administrative costs of monitoring and implementing such an arrangement is also cumbersome and complicated requiring a lot of red tape and paper work to guarantee its effective operation.

International best practice bears witness to the fact that the most preferable and favorable option is for NGOs to be zero-rated. It has emphatically been stated time and again that being zero-rated is much more better and beneficial to NGOs than being granted total exemption from VAT.

Second best is being given lower rating. Again experience has born that this is also better and beneficial for NGOs and can be cited as one way of offering beneficial tax treatment to NGOs by governments.

Whatever option or alternative the NGO community opts for, it must be predicated on in-depth discussion and on the commonly shared conviction that this is the best option that can offer beneficial tax treatment to NGOs across the board and must be made the mission statement that will guide the engagement between the NGO community and the tax authorities.

This brings us to yet another area that needs to be seriously considered and this is the need to solicit the opinion of all stakeholders in this matter. These include donors, the NGOs/CSOs, beneficiaries and yes, state actors within relevant and applicable ministries and other government institutions.

We need to create a discussion forum whereby all the stakeholders can meet, discuss and reason together.

We further need to elect and constitute a truly representative task force that can and will primarily facilitate the creation of the said forum and spearhead and oversee the compilation and harmonization of opinions and comments forwards in such forum and represent the NGOs/CSOs in the engagement and negotiation process with relevant and applicable state actors.

As a long term strategy to deal with taxation of the NGOs in general, it is necessary for the NGOs to initiate a process to influence the policy framework on taxation for NGOs, with regard to the goals, objectives and activities that NGOs are involved in. The NGOs

should therefore consult effectively with the Ministry of Finance and bring to bear the enormous contribution NGOs make to the economy and well being of the citizens, hence the need for the government to come up with legislation that are appropriate and sensitive to the NGOs' activities and sources of income.

The taxation of NGOs should be viewed from a different angle other than the commercial business one, since this two are completely divers and more often with opposing missions and objectives.

In conclusion let it be said that the NGO community should proceed with haste and the requisite caution and prudence that an endeavor of such nature and magnitude calls for and requires.

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