Carryover Problems and Emerging Concerns: A Review on Value Added Tax Legal Reforms of Ethiopia

Gidey Belay Assefa♣ and Debes Tukue♣♣

Abstract

This article critically examines Ethiopia's newly introduced Value Added Tax (VAT) legal reforms. VAT Proclamation No. 1341/2024 and its accompanying VAT Regulation No. 570/2025 have introduced significant changes to the tax regime, along with unresolved issues, controversies and ambiguities. Through a doctrinal analysis of this legal reform, supplemented by interviews with experts from banks and insurance companies, this article critically highlights the unresolved issues and ambiguities in the legal reforms. Expanding the scope of taxable activities, particularly in the financial services sector, has sparked considerable debate among businesses. The continuation of taxing foreclosures also poses problems to the banks, as valuations of properties have been done without accounting for the VAT that would be levied if the debtor defaults and the property is foreclosed. Moreover, the ambiguities related to VAT-inclusive pricing may persist due to the unclear provisions of the legal reform, implicating limited stakeholder engagement in the tax reform process. Therefore, this article highlights the need for greater clarity and fairness in the VAT laws of Ethiopia.

Keywords: Value Added Tax, Financial Services, Exemptions, VAT-inclusive, Foreclosure

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1. Introduction

Major legislative reform is the proudest achievement of the current Ethiopian government, albeit contested.[1] Since 2018, several new laws have been enacted, and many existing laws have been amended.[2] Tax law is among the areas that have received frequent and controversial changes. Almost all tax law categories – including VAT[3], excise tax[4], and property tax[5] have been amended.

Reforms on tax laws can have several goals, including increasing revenue and efficiency in administration and influencing consumer behaviour.[6] The goal informs the choices governments make in the new laws, such as who and what may be taxed or exempted, to broaden the tax base or improve compliance with existing taxes and so on. And such choices are usually informed by taxation theories such as the ability to pay, which attaches tax to the amount of income the person receives, benefit theory that links tax with the amount of service the person receives from the state, or personal expenditure that taxes individuals based on their consumption.[7]

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[1] Ethiopian News Agency, *Ethiopia Achieves Considerable Legislative reforms, Modernization: Justice Ministry*, < https://www.ena.et/web/eng/w/en_33451> accessed on April 14, 2025. However, the legislative reforms of this time are blamed for being frequent, creating uncertainty, fast, lacking sufficient deliberations and public consultations, and sometimes contradictory. See Ashenafi Endale, *Hurried Media Bill Backpedals Recent Reforms, Threatens Press Freedom, The Reporter < https://www.thereporterethiopia.com/42794/ > accessed on April 14, 2025;* The Reporter, *Refraining from Engaging in Legislative Frenzy*, < https://www.thereporterethiopia.com/43310/ > accessed on April 14, 2025. Gidey Belay Assefa, 'Alternative Dispute Resolution in Ethiopia: Problems of the Recent Legislative Reforms', (Conference Paper, 2022) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4352595> accessed on April 17, 2025.

[2] New laws include capital markets, data protection, administrative procedure, and hate speech laws while amended laws include investment, media, terrorism, civil society, tax laws, etc.

[3] See, for instance, Value Added Tax Amendment Proclamation, 2019, Proc. No. 1157/2019, *Fed. Neg. Gaz.*, Year 25, No. 81, and Value Added Tax Proclamation, 2024, Proc. No. 1341/2024, *Fed. Neg. Gaz.*, Year 30, No 61.

[4] Excise Tax Proclamation, 2020, Proc. No. 1186/2020, *Fed. Neg. Gaz.*, Year 26, No 25.

[5] Addis Standard, *Parliament approves property tax bill amid concerns over its impact on fixed-income citizens*, < https://addisstandard.com/parliament-approves-property-tax-bill-amid-concerns-over-its-impact-on-low-income-citizens/> accessed on April 17, 2025.

[6] Jane Frecknall-Hughes, *The Theory, Principles and Management of Taxation*, (Taylor and Francis, 2014) p.4.

[7] Robin Boadway and Katherine Cuff, *Tax Policy: Principles and Lessons*, (CUP, 2022) pp. 2-6.

The main goal for the current tax reform in Ethiopia seems to be revenue generation. As the Minister of Finance, Ahmed Shide, presented to the parliament in June 2024, the government revenue has been severely affected by the recurring conflicts and the cessation of support from development partners in the post-2018 period of Ethiopia.[8] As a result, the government decided to cover 51.7% of the 2025 budget from taxes.[9] In doing so, the government broadened the tax base by introducing new taxable activities. For instance, a social welfare levy tax and a property tax have been introduced.[10] Two other directives have been issued to improve the enforcement and rate of excise taxes.[11] In this pursuit, laws related to the Value-Added Tax (VAT) have undergone continual amendments, including the revision of the list of exempted items.[12]

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[8] Addis Standard, *Ethiopia eyes new tax reforms to power its near trillion-birr budget for upcoming fiscal year*, <https://addisstandard.com/ethiopia-eyes-new-tax-reforms-to-power-its-near-trillion-birr-budget-for-upcoming-fiscal-year/#:~:text=These%20plans%20involve%20amending%20current,billion%20birr%20in%20tax%20revenue>, accessed on August 30, 2024.

[9] *ibid*. The government has introduced and is introducing additional mechanisms of revenue generation and funding projects including forced contributions from companies and employees. See Addis Standard, *new bill tabled to legislators proposes salary deductions from gov't, private employees for disaster relief funding*, < https://addisstandard.com/new-bill-tabled-to-legislators-proposes-salary-deductions-from-govt-private-employees-for-disaster-relief-funding/>, accessed on April 16, 2025; Addis Standard, *Harari regional government refutes reports of business closures over 'corridor development levy', cites building code violation,* < https://addisstandard.com/harari-regional-govt-refutes-reports-of-business-closures-over-corridor-development-levy-cites-building-code-violations/> accessed on April 17, 2025.

[10] A social welfare levy tax on imported goods has been introduced, levying 3% of the CIF value of imported goods. The reason for such introduction was, as stated in the preamble of the regulation, to generate additional revenue "for the rehabilitation and construction of education, training and medical facilities and expansion of other social services". See Social Welfare Levy on Imported Goods Regulation, 2022, Art. 4 & 5, Reg. No. 519/2022, *Fed. Neg. Gaz.*, Year 28, No. 48. For the property tax, the parliament has approved a proclamation. See *supra note* 5. The Addis Ababa City Administration has also updated the tax rates in 2023. See Property Tax Amendment Notification Letter issued by Addis Ababa City Administration Revenues Bureau, dated 12 June 2023, <https://www.lawethiopia.com/images/addis%20ababa/revised%20property%20tax%20addis%20ababa.pdf>, accessed on August 30, 2024.

[11] The Excise Stamp Management Directive, 2024, Dir. No 1004/2024; A Directive Issued to Make Adjustments to the Specific Rates of Excise Tax, 2024, Dir. No. 1007/2024.

[12] Value Added Tax Amendment Proclamation No. 1157/2019; A Directive to Provide Goods Exempt from Value Added Tax, 2024, Dir. No. 1006/2024.

In 2024, a proclamation was enacted[13] and a regulation has been subsequently issued in 2025.[14] These two laws have made changes to the scope of application and administration of VAT. However, they have faced criticisms from the business community because they tried to tax activities that were exempt under the previous laws. The new laws, among others, aim to tax debt collection services, fee-based services of financial institutions, short-term insurance services and foreclosure sales.[15] Several banks and insurance companies, and their associations, have complained that the changes would discourage investment and undermine the affordability and accessibility of financial services.[16] Moreover, some problems arose due to a lack of clarity on the previous VAT laws. For instance, whether a stated price of a good is VAT inclusive in the absence of an express agreement between the parties was contentious at least until the Federal Supreme Court Cassation Division decides on the matter.[17] Nevertheless, the new proclamation neither expressly confirms nor changes the decision of the court. As a result, the problem may persist during the implementation of the new proclamation.

This article aims to review the VAT legal reforms of Ethiopia, suggesting that the focus on revenue generation has limited the reform's ability to address several challenges. It highlights selected issues that the new laws failed to address and the new challenges introduced. Through a doctrinal analysis of the laws, supplemented by interviews with purposefully selected lawyers and finance experts working in various banks and insurance companies, it shows that the VAT reform fails to resolve

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[13] Value Added Tax Proclamation No. 1341/2024.

[14] Value Added Tax Regulation, 2025, Reg. No. 570/2025, *Fed. Neg. Gaz*. Year 31, No. 31

[15] Value Added Tax Proclamation No. 1341/2024, Art. 10, Annex 2, 1(c) and 2(b) regarding the definition of financial services; Value Added Tax Regulation No. 570/2025, Art. 53(4)(d); Explanatory note to notify the new additions in the Value Added Tax Proclamation No. 1341/2024, section 3.9. (Explanatory note). See also Circular No. ታ/ከ/ቀ/5/33 dated 17/07/2005 EC.

[16] Aksha Italo, *Commercial Banks in VAT Crosshair*, Addis Fortune, <https://addisfortune.news/commercial-banks-in-vat-crosshairs>, accessed on September 04, 2024.

[17] *ዳይናሚክ ሎጂስቲክስ ሳፕላይ ሳፖርት ሰርቪስስ vs. አቶ ፈሬሳ ኢዶ ፤ የፌዴራል ጠቅላይ ፍርድ ቤት ሰበር ሰሚ ችሎት፤ መ.ቁ 194135፤2013 ዓ.ም* (ዳይናሚክ ሎጂስቲክስ ሳፕላይ ሳፖርት ሰርቪስስ *vs. አቶ ፈሬሳ ኢዶ)*

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some of the existing challenges and lacks clarity and fairness due to legal ambiguities and unresolved issues. The concern of clarity and fairness implicates limited stakeholder engagement in the tax reform process and can affect compliance.

This article is organised into five sections, including this introduction. Section two provides the theoretical foundations of tax reform, VAT, exemptions, taxation of financial services, and VAT inclusive/exclusive pricing. The third section is an overview of the VAT laws in Ethiopia, including exemptions and the old problems. Section four discusses the key changes, unresolved old problems and concerns of these new changes. Finally, section five offers concluding remarks.

2. Principles and Concepts of Tax and VAT Reforms

2.1. Principles and Concepts of Tax Reforms

Tax reforms can have one or more goals. The main purpose, usually, is to increase revenue for the government.[18] Beyond revenue generation, tax reform may aim at shaping consumer behaviour by increasing taxes on luxury or harmful items, or at encouraging certain investments by providing a tax holiday or reduced taxes.[19] It can also aim at reducing wealth gaps between individuals by making taxpayers pay according to their ability to pay. Additionally, tax reform may seek to modernise the tax administration system.[20]

Tax reforms involve a series of decisions, including whether to broaden the tax base or to improve the compliance of taxpayers, or whether income or consumption must be taxed, or which sectors must be exempted from tax. Such decisions are dependent on various factors including the level of development of the country, the need for public services, the availability of alternative sources of funds, and the capacity to tax. They are informed by one or more foundational principles and theories.[21] For

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[18] Richard M. Bird and Eric M. Zolt, 'Tax Policy in Emerging Countries, Environment and Planning C: Government and Policy' Vol. 26, 2008, p. 76

[19] Frecknall-Hughes J, *supra note 6*.

[20] *ibid*

[21] Bird R. and Zolt E., *supra note* 18, p.75.

instance, on questions of who and how much should pay taxes, the principles of ability-to-pay and benefit are often cited and applied. The ability to pay dictates that taxes should correspond to the people's financial ability.[22] According to benefit theory, on the other hand, taxes must be levied based on the benefits people receive from the state, not based on the income they receive.[23] According to optimal taxation theory, tax laws must be designed in a way that balances efficiency and equity. One manifestation of this balance is that basic goods and services must be taxed lower rate than those goods and services consumed by rich people.[24] In the administration of tax, tax morale theory dictates that a tax system must improve the taxpayers' willingness to pay tax.[25] Tax morale is directly linked to the perception of citizens towards the tax system's fairness.[26]

Irrespective of what theories have been adopted, a tax reform must be adequate, equitable, and efficient.[27] This means it must generate adequate revenue for the projects that the government wants to implement, that it must be fair (both vertically and horizontally) in levying taxes on different segments of society, and that it must reduce the social costs of tax.

2.2. The Concepts of VAT, Exemptions, and VAT Inclusive/Exclusive Pricing

VAT is a consumption tax applied to goods and services in proportion to their price at each stage of the production and distribution process.[28] The key feature of VAT is

[22] Boadway R. and Cuff K., *supra note* 7.
[23] *ibid*
[24] Camilla Fagner de Carvalho e Costa and Jeferson de Castro Vieira, 'Optimal Tax Theory Its Contributions to the Brazilian Reality, Journal of Contemporary Administration' Vol. 25. No. 2, 2020, p.3.
[25] Erzo F. P. Luttmer and Monica Singhal, 'Tax Morale, Journal of Economic Perspectives', Vol. 28, No. 4, 2014, p. 149.
[26] OECD, *Tax Morale: What Drives People and Business to Pay Tax?'* (2019, OECD).
[27] Bird R. and Zolt E., *supra note* 18.
[28] Ann Brockmeyer et al, 'Does the Value Added Tax Add Value? Lessons Using Administrative Data from a Diverse Set of Countries, Journal of Economic Perspectives', Vol. 38 No. 1, 2024, p.

that it ensures only the added value at each transaction stage is taxed, with deductions allowed for the VAT already paid on prior stages.[29] In principle, VAT is neutral, taxing consumption at each stage of the supply chain.[30] However, certain transactions may be exempt from VAT for various reasons, such as reducing the tax burden on critical sectors, promoting access to necessary services, or supporting specific industries.[31]

VAT is typically paid by the consumer, although the seller is responsible for collecting and remitting the tax to the government.[32] In fact, in what's known as reverse taxation, the consumer of VATable goods and services could withhold the tax and report it to the government.[33]

One of the important questions in designing VAT legislation is whether prices should be VAT-inclusive or VAT-exclusive. According to the Association of International Certified Professional Accountants, one of the 12 principles of good tax policy is transparency and visibility, meaning taxpayers should know that a tax exists and how it is imposed.[34] Given that VAT is paid by the buyer, the question arises whether the price should be VAT-inclusive or exclusive. VAT-inclusive pricing simplifies

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108; First Council Directive of 11 April 1967 on the harmonization of legislation of member states concerning turnover taxes (67/227/EEC) (OJ P 71, 14.4.1967, P. 1301), Art. 2.

[29] *ibid*

[30] Antonov, Lyubomir, "Value Added Tax on Financial Services in the EU: The Complete Story", *Review of European and Comparative Law*, Online First: 6 August 2024, https://doi.org/10.31743/recl.17166, p. 126.

[31] Alan Schenk, Victor Thuronyi, Wei Cui, *Value Added Tax: A Comparative Approach*, (2nd ed, CUP, 2015) p. 269-281.

[32] Organisation for Economic Cooperation and Development (OECD), *International VAT/GST Guidelines on Neutrality*, 2011, p. 3 < https://www.oecd-ilibrary.org/docserver/9789264271401-en.pdf?expires=1730603912&id=id&accname=guest&checksum=F4FF9D3D45BB3128F7E14EC7AB5B51B2> accessed on November 01, 2024.

[33] Some jurisdictions require government authorities to withhold some portion of the VAT. And in cases of transaction which involves a non-resident party, the government requires the resident buyer to withhold and pay the whole VAT. See, for instance, The Ethiopian Value Added Tax Proclamation 1341/2024, Arts. 62 and 65.

[34] Association of International Certified Professional Accountants, *Guiding principles of good tax policy: A framework for evaluating tax proposals*, 2001, p. 3 https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf accessed on November 01, 2024.

purchases by presenting a single price without requiring tax calculations. However, it lacks transparency as consumers do not see how much VAT they pay, reducing public engagement with fiscal policy.[35] For businesses, it complicates accounting, as they must distinguish between net prices and VAT. VAT-exclusive pricing, on the other hand, provides transparency by showing consumers the tax's impact on their purchase, promoting accountability and easier accounting.[36] But it may frustrate consumers when tax is added at checkout, potentially discouraging spending in price-sensitive markets.

Whatever the approach, the law must provide clarity for cases where parties fail to agree. Countries such as the Bahamas have clear provisions stating that the price labelled on goods and services includes VAT.[37] In such countries, the seller cannot argue later that the price was VAT-exclusive and, in some cases, doing so is punishable under consumer protection laws of many countries for providing a misleading price.[38] In many states of the US, on the other hand, the sales tax (though not VAT) is not included in the price and states such as Nebraska require that the tax be provided separately from the price.[39]

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[35] W. Jack Millar, 'Policy Forum: the Case for Maintaining Tax-Exclusive Pricing, Canadian Tax Journal', Vol 58 No. 1, 2010, p. 83; Richard M. Bird 'Policy Forum: Visibility and Accountability: Is Tax-Inclusive Pricing a Good Thing, Canadian Tax Journal', Vol 58 No. 1, 2010, p. 75.

[36] Millar J, *ibid*, p. 83.

[37] Bahamas Value Added Tax Regulations, 2014, Section 37(2). As the giant consultant, KPMG, rightly stated the law provides that the price includes VAT when the contract is silent. See KPMG, *Contracts and VAT*, 2017, <https://assets.kpmg.com/content/dam/kpmg/bs/pdf/2017-08-VAT-and-contracts-v2.pdf> accessed on 31 October 2024.

[38] See, for instance, New Zealand's Fair Trading Act 1986, section 13(g).

[39] Section 77-2703(c) of the 2019 Nebraska Sales Tax Statute states as follows: "The tax required to be collected by the retailer from the purchaser, unless otherwise provided by statute or by rule and regulation of the Tax Commissioner, *shall be displayed separately from the list price*, the price advertised in the premises, the marked price, or other price on the sales check or other proof of sales, rentals, or leases." (emphasised)
See Legislative Bill 237, 2019, <https://revenue.nebraska.gov/sites/default/files/doc/info/legislation/2019/LB237.pdf> accessed on 31 October 2024.

The other question in designing VAT legislation is the issue of exemptions. Financial services are among the commonly exempted items in tax systems in many jurisdictions.[40] The common reason for such exemption is that it is difficult to identify the value-added or taxable amount for VAT purposes in many financial services.[41] It is also argued that taxation of financial services would discourage investment and undermine the affordability and accessibility of financial services.[42]

However, the exemption of financial services also has its drawbacks. This is because banks and insurance companies cannot deduct input VAT on their purchases; they may, however, increase the charges for their services to compensate themselves.[43] So, their price has a hidden cost of VAT. As a result, businesses will not be able to recover the embedded VAT. This negatively affects them. Even if it does not have a hidden cost, the fact that the financial institutions are not able to recover their input VAT is against the principle that it must be borne by the end consumer.[44]

As a result, some countries have redefined financial services by taxing certain aspects of the services. For instance, South Africa has expanded the scope of the tax by taxing fee-based financial services and government services such as utility charges.[45] In addition, there are efforts in the European Union (EU) to tax or redefine financial services. However, these efforts have not been successful as stakeholders

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[40] For the purposes of this Article, financial services include insurance services.

[41] Lyubomir A, *supra note* 30, p. 126.

[42] Geminiano L. Sandoval Jr., *Taxation in financial services under TRAIN*, Philippine Institute for Development Studies, < https://pidswebs.pids.gov.ph/CDN/PUBLICATIONS/pidspn1903_rev.pdf> accessed on 17 February 2025.

[43] *ibid*

[44] Altenburger, O. A., Diewald, R., & Göttsche, M., 'The inclusion of insurance services in the European VAT system—a problem that cannot be solved? Zeitschrift für Versicherungswesen', Vol. 111, p.339–352; see also
Organisation for Economic Cooperation and Development (OECD), *International VAT/GST Guidelines on Neutrality*, 2011, p. 3 < https://www.oecd-ilibrary.org/docserver/9789264271401-en.pdf?expires=1730603912&id=id&accname=guest&checksum=F4FF9D3D45BB3128F7E14EC7AB5B51B2> accessed on November 01,2024,

[45] Schenk A., Thuronyi V., Cui W., *supra note* 31, p. 58.

raised concerns about their impact on end consumers.[46] Reports show that taxing mobile money and other financial technologies in undeveloped countries may hurt the development of the industry. In Tanzania, the introduction of VAT and other taxes raised transaction costs, prompting users to revert to cash payments.[47] This shift reduced revenue from the mobile money sector, subsequently impacting investment in the industry.[48]

3. Value-Added Tax Laws, Exemptions, and Problems in Ethiopia

3.1. Value-Added Tax Laws

In Ethiopia, VAT was introduced in 2002 through the repealed VAT Proclamation No. 285/2002 and Regulation No. 79/2002, replacing the sales tax.[49] According to this proclamation, all transactions were subject to VAT except for the listed items under Article 8 and any other exemptions that the Ministry of Finance may make in accordance with Article 8(4.[50] Among the exempted transactions were the provision of financial services, the supply of electricity, kerosene and water, and the provision of transport.[51] Regulation No. 79/2002 provides explanations for these exempted items without containing any additional list of exempt items. [52]

The Ministry of Finance had also exempted some other transactions, including but not limited to the supply of food grain, materials used for the production of mosquito

[46] European Commission, *Consumer financial services action plan: better products and more choice for European consumers, press release* < https://ec.europa.eu/commission/presscorner/detail/en/ip_17_609> accessed on November 01, 2024.
[47] Global System for Mobile Communications, Tanzania Mobile Money Levy Impact Analysis: Reports from 1st July to 31st December 2021, 2021 <https://www.gsma.com/solutions-and-impact/connectivity-for-good/public-policy/wp-content/uploads/2021/12/spec_tanzania_mm_report_02_22-1.pdf>, accessed on November 3, 2024.
[48] *ibid*. Other authors have also expressed their concern of taxing mobile money in Africa. See Favourate Y. Mpofu, 'Industry 4.0 in Financial Services: Mobile Money Taxes, Revenue Mobilisation, Financial Inclusion, and the Realisation of Sustainable Development Goals (SDGs) in Africa, Sustainability' 2022 Vol. 14.
[49] Value Added Tax Proclamation No. 285/2002.
[50] *ibid*, Art. 7.
[51] *ibid*, Art. 8.
[52] Article 19 to 33 of the Value Added Tax Regulation No. 79/2002

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nets, medicine and medical kits, airplane tickets, injera, and the publication of books[53]. Concerning foreclosure, the tax authority passed a circular subjecting it to VAT after it lost a case at the Federal High Court.[54] The Proclamation No. 285/2002 was amended twice – in 2008[55] and 2019.[56] However, none of these amendments provides for additional exemptions or reduces the exempted items.

In June 2024, the Ministry of Finance issued a directive listing goods exempted from VAT.[57] The purpose of this directive was to narrow down the exemption, as previous blanket exemptions reduced government revenue by repealing all exemptions made by the previously issued directives.[58] As a result, the exemptions made through different directives were no longer applicable until they were reinstated by including them in the list of exempt items in the new Proclamation No. 1341/2024.

3.2. Problems in the Previous VAT Regime

The previous laws gave rise to several practical challenges, largely due to their lack of clarity. A prominent issue was the question of whether the selling price of a good

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[53] See, for instance, Circular Ref. No. 3/16/28/171 Dated 11/10/1997 E.C, and Circular Ref. No. 3/16/28/185 Dated 05/09/1997 E.C

[54] See Circular No. ታ/ከ/ቀ/5/33, dated 17/07/2005 EC; See also *Abyssinia Bank vs. Federal Inland Revenue Authority*, Federal Tax Appeal Commission, File No. 543 cited in Tadesse Lencho, 'To Tax or Not To Tax: Is that Really the Question, VAT, Bank Foreclosure Sales, and the Scope of Exemptions for Financial Services in Ethiopia, Mizan Law Review' Vol. 5, No. 2, 2011, P. 267.

[55] Value Added Tax Amendment Proclamation, 2008, Proc. No. 609/2008, *Fed. Neg. Gaz*. Year 15, No. 6.

[56] Value Added Tax Proclamation No. 1157/2019.

[57] A Directive to Provide Goods Exempt from Value Added Tax No. 1006/2024.

[58] *ibid*, Art. 2. It states as follows. "Exemption from Value-Added Tax

1) In addition to goods listed under Article 8(2) of the Value Added Tax Proclamation No. 285/2002 (as amended) and Article 19 to 33 of the Value Added Tax Regulation No. 79/ 2002, goods produced locally and imported from abroad listed in the Annex to this Directive shall be exempt from Value Added Tax.
2) With the exception of goods mentioned under sub article 1 of this Article, all goods and services that have been exempt through various Directives issued or decisions made by the Ministry of Finance heretofore shall be subject to Value Added Tax as of the date in which the Directive enters into force.
3) The provisions of sub-article 2 of this Article shall not apply to decisions made by the Ministry of Finance with respect to goods and services that are exempt under international agreements to which Ethiopia is a party as well as to arrangements made for payment of Value Added Tax."

or service should be considered VAT-inclusive when the parties involved failed to explicitly agree. With no specific provision to resolve the issue, parties frequently turned to litigation to seek clarification. This continued until 2021, when the Federal Supreme Court Cassation Division issued a binding decision.

In *Dynamic Logistics Supply Support Service v. Mr. Feresa Edo* (2021), the applicant sold a bus for 310,000 Birr.[59] When the applicant requested the outstanding payment, he maintained that the buyer still owed an additional 46,500 Birr in VAT that was not included in the initial payment. The respondent, however, argued that there was no explicit agreement regarding the payment of VAT, and therefore, he was not liable for the VAT amount. The Federal Supreme Court Cassation Division, upholding the decisions of the lower court, ruled that in situations where there is no clear agreement between the parties regarding VAT, the buyer is only required to pay the agreed-upon price, treating the selling price as VAT-inclusive.

In another case before the Federal High Court, *ARTS TV v. Ministry of Revenues* (2023), *ARTS TV* agreed to advertise a client's product for a specified sum.[60] The Ministry of Revenues calculated VAT by treating the selling price as the base price, assuming it did not include VAT. In contrast, *ARTS TV* argued that the price should be considered VAT-inclusive. The High Court ruled in favour of *ARTS TV*, affirming that, in the absence of a clear agreement, the selling price is presumed to be VAT-inclusive.

In contrast, the Federal First Instance Court, in *Mr Mengistu Yeshitila v. B&Y Poultry Farm PLC* (2021), held that VAT is an indirect tax that must be paid by the buyer in case the parties fail to expressly agree otherwise, treating the selling price VAT-

[59] ዳይናሚክ ሎጂስቲክስ ሳፕላይ ሳፖርት ሰርቪስስ vs. *አቶ ፈሬሳ ኢዶ*

[60] አርትስ ቲቪ vs. የገቢዎች ሚንስቴር፤ የፌዴራል ክፍተኛ ፍርድ ቤት፤ መ.ቁ 296100፤ 2015 ዓ.ም. (አርትስ ቲቪ vs. የገቢዎች ሚንስቴር)

exclusive.[61] These contradicting decisions show the lack of clear provisions addressing the issue.

Another problem was concerning the taxation of foreclosure. Banks value properties without considering the VAT that may be applied if the property was to be foreclosed. It is common for banks to encounter situations where they are unable to fully recover their loans because VAT is applied to a property value that did not originally account for it at the time of valuation.

4. Key Changes, Carryover Problems, and New Concerns

4.1. Key Changes

The new VAT Proclamation and Regulation have introduced several changes in the application and administration of VAT. The self-proclaimed purposes of these changes are to encourage savings and investment, generate revenue, make the proclamation understandable, clear and easy, and ensure fairness by providing exemptions to those who deserve it alone.[62] The application of VAT now extends to digital services, even when provided from abroad by unregistered people[63] and traditional services that were previously exempt.[64] Administratively, the annual taxable supply eligible for mandatory VAT registration has become 2 million birr[65], and many provisions have been amended for clarity purposes.[66]

Regarding exemption, the new Proclamation (no. 1341/2024) states that all items listed in Annexe 2 are exempted.[67] According to Annexe 2, financial services

[61] አቶ መንግስቱ የሺጥላ vs. ቢዋይ የዶሮ እርባታ ሀላፊነቱ የተወሰነ የግል ማህበር፤ የፌዴራል ጠቅላይ ፍርድ ቤት፤ መ.ቁ 19094, 2013 ዓ.ም. (አቶ መንግስቱ የሺጥላ vs. ቢዋይ የዶሮ እርባታ ሀላፊነቱ የተወሰነ የግል ማህበር)
[62] Value Added Tax Proclamation No. 1341/2024, Preamble.
[63] *ibid*, Art 23, 24, and 25.
[64] These include utilities such as electricity and water supply services, and goods or services provided by employer to the employee free of charge. See *ibid*, Annexe II (1); Value Added Tax Regulation No.570/2025, Art. 10(3).
[65] *ibid*, Art. 12(2).
[66] See, for instance, *ibid*, Art. 45 & 46.
[67] Value Added Tax Proclamation No. 1341/2024, Art. 10.

provided by banks and other financial institutions are exempted.[68] It then elaborates on the scope of these exempt items by defining them. For example, in principle, financial services are exempted. However, the Proclamation excludes some services from the definition of financial services. These include debt collection and factoring, financial technologies, [69] short-term insurance, and settlement of insurance compensation.[70] The VAT regulation also identifies additional items eligible for exemption.[71] It also elaborates on some of the listed items in Proclamation No. 1341/2024. It explains which parts of the financial services, residential houses, guarantee documents, Islamic financial services, religious services, medical services, educational programs, and humanitarian aid are exempt.[72] When defining exempted financial services, the regulation explicitly excludes activities such as organising or summarising legal, accounting, actuarial, notary, and tax agency services when rendered to the financial service or its customer.[73] In addition, services like safeguarding cash or important documents[74], processing data and payroll[75], and collecting debts and factoring are also excluded[76]. Lastly, , acting as a trustee, providing financial advice or asset management[77], and leasing or licensing assets that aren't financial instruments[78] are not considered exempt financial services.

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[68] See A Directive to Provide Electricity and Water Consumption Exempt from Value Added Tax, 2024, Dir. No. 1021/2024, Ministry of Finance.
[69] Value Added Tax Proclamation No. 1341/2024, Art. 10, Annex 2, 1(c) and 2(b).
[70] Explanatory note 3.10; Value Added Tax Proclamation No. 1341/2024, Annex 2.
[71] These include veterinary medicines, medicine sprinklers, inputs for manufacturing of medical devices and prescription medicines, cereals and pulses, cooked or prepared foods etc. Value Added Tax Regulation No. 570/2025, Art. 52 and Annex 1.
[72] *ibid*, Art. 53-61
[73] *ibid*, Art. 53(4) (a).
[74] *ibid*, Art. 53(4) (b).
[75] *ibid*, Art. 53(4) (c).
[76] *ibid*, Art. 53(4) (d).
[77] *ibid*, Art. 53(4) (f).
[78] *ibid*, Art. 53(4) (g).

Also, the new Proclamation levies VAT for certain fintech services, particularly those involving money transfers, as well as advisory and administrative services, as stated above.

From this perspective, there are a few concerns posed by the new laws and old problems that may require a second thought. As demonstrated in the subsequent sections, some of the provisions lack clarity, discourage investments in some financial services, and are perceived as unfair by different segments of society.

4.2. Carryover Problems

As stated above, one of the most contentious issues before the enactment of the new Proclamation was whether an agreed price should be treated as VAT-exclusive when the parties have not explicitly stated otherwise. In most cases, taxpayers tended to assume that the agreed price of a good or service included VAT, leading to the conclusion that the selling price already reflected the tax. However, the Ministry of Revenue often took the opposite stance.

This difference in interpretation frequently led to disputes between the Ministry and taxpayers, as it directly impacted the amount of VAT payable and the overall cost to the buyer. Such controversy also arises between taxpayers when the seller demands payment of VAT in addition to the selling price of the service or good. However, this was finally settled by the Federal Supreme Court Cassation Division in *Dynamic Logistics Supply Support Service v. Mr. Feresa Edo* (2021). [79] Some lower courts have followed this binding rule in similar cases[80] while others have defied it[81]. The courts in these rulings stressed that no provision obliges the seller to state whether the selling price includes VAT.

[79] ዳይናሚክ ሎጂስቲክስ ሳፕላይ ሳፖርት ሰርቪስስ vs. *አቶ ፈሬሳ ኢዶ*

[80] አርትስ ቲቪ vs. የገቢዎች ሚንስቴር.

[81] See the summaries of the Federal First Instance Court ruling in the አቶ መንግስቱ የሺጥላ vs. ቢዋይ የዶሮ እርባታ ሀላፊነቱ የተወሰነ የግል ማህበር case.

What the new VAT proclamation (1341/2024) has done is that it included a provision to oblige the seller to state whether the price is VAT-inclusive. Article 68 reads as follows.

> "1) Subject to Sub-Article (2), any price advertised or quoted by a registered person in respect of a taxable supply shall include VAT and this shall be stated in the advertisement or quotation.
>
> 2) A registered person may advertise or quote a price in respect of a taxable supply as exclusive of VAT provided: a) the advertisement or quotation also states the amount of VAT charged on the supply and the price inclusive of VAT; and b) the price inclusive of VAT and the price exclusive of VAT shall be advertised or quoted with equal prominence or impact.
>
> 3) Subject to Sub-Article (4), price tickets on goods supplied by a registered person do not need to state that the price includes VAT if this is stated by way of a notice prominently displayed at all entrances to the premises in which the registered person carries on a taxable activity and at all points in such premises where payments are made by customers.
>
> 4) The Tax Authority may, in the case of any registered person or class of registered persons, approve any other method of displaying prices of goods or services by such persons.
>
> 5) Where a person who is not registered for VAT bids for a tender: a) the person shall quote in the tender a price without VAT; and b) if, as a result of being awarded the tender, the person is liable to be

registered under Article 12, the person shall recover VAT on taxable supplies made about the tender."[82]

At first glance, the heading and sub-article 1 appear to resolve the issue by stating that the price shall include VAT. However, the second part of the provision, which requires that "this shall be stated in the advertisement or quotation," raises important questions. What happens if the seller fails to indicate that the price includes VAT, as required by the law, including through the means stated in the subsequent sub-articles? This is not clear from the provision, and the answer to this question can have different implications depending on the situation.

On one hand, one might argue that the default rule holds that the price includes VAT, and the seller's failure to state this explicitly does not change the obligation. If this is the case, what is the purpose of imposing such a requirement on the seller to state it? On the other hand, it could be argued that the seller's failure to declare the price as VAT-inclusive should be treated as a penalty, meaning the seller must bear the cost of VAT it failed to collect. However, this interpretation overlooks a critical point: VAT is not a penalty and cannot be paid by the seller. Moreover, if the seller were to require the buyer to pay the VAT, it would be unjust for the buyers who purchased under the assumption that the agreed price includes VAT and the seller does not clarify otherwise, as seen in the *Dynamic Logistics Supply Support Service v. Mr. Feresa Edo* case.[83] The law provides a clear exception in cases where an unregistered taxpayer bids for a tender and becomes liable for registration after winning the bid. In such cases, the taxpayer must collect VAT even though he is required to provide a VAT-exclusive price at the bidding time.[84]

Therefore, the new VAT proclamation, by not explicitly addressing the consequences of the seller's failure to state or show whether the price includes VAT,

[82] Value Added Tax Proclamation No. 1341/2024, Art. 68

[83] ዳይናሚክ ሎጂስቲክስ ሳፕላይ ሳፖርት ሰርቪስስ vs. *አቶ ፈሬሳ ኢዶ*

[84] Value Added Tax Proclamation No. 1341/2024, Art. 68(5).

leaves room for continued uncertainty. While some might argue that the prior Cassation Division ruling has already settled this issue, the change in the law's wording could impact how future disputes are resolved. In other words, it could be argued that the legal framework has changed and that the altered language might allow for distinctions between past rulings and future cases. This uncertainty underscores the need for clearer legislative guidance to prevent further confusion in VAT-related disputes.

Another significant issue arises in the taxation of foreclosed properties. While there are valid arguments both in favour of and against taxing foreclosure transactions, such taxation has been mandated since the issuance of Circular No. ታ/ከ/ቀ/5/33.[85] However, the core problem faced by financial institutions is not the imposition of the tax itself, but rather the way the taxation is applied.

In practice, properties held as collateral by banks are often valued without accounting for the VAT that would be levied if the debtor defaults and the property is foreclosed.[86] Typically, the valuation reflects the price a buyer would be willing to pay in an open sale, without factoring in the VAT that would be due during foreclosure. However, in reality, the net value of the property is reduced by the VAT portion, effectively diminishing the actual amount recoverable by the bank.

Unfortunately, this issue remains unaddressed in the amended VAT Proclamation. The amended law continues to uphold the taxation of foreclosure without offering any solution to the problem. Article 42 states that

> "1/ If a creditor, whether registered or unregistered, supplies the goods of a debtor to a third person in full or partial satisfaction of a debt owed by the debtor to the creditor: a) the supply to the third person shall be

[85] MOF Circular No. ታ/ከ/ቀ/5/33 dated 17/07/2005 EC
[86] Interview with Yonas Aynalem Hagos, Foreclosure Division Manager at Lion International Bank, Addis Ababa, on 15 September 2024.

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> treated as having been made by the debtor and the nature of the supply under this Proclamation shall be determined accordingly, and b) the creditor shall be liable to pay the VAT payable on the supply unless the debtor provides the creditor with a written statement that the supply is not subject to VAT."[87]

The creditor (bank) is liable to pay VAT unless proven otherwise, either through a written statement of the debtor or other means. Additionally, the bank is not entitled to credit for any input tax the bank incurred in making the supply.[88]

As a result, financial institutions are left to grapple with the same challenges, as the discrepancy between property valuation and VAT application persists, undermining the banks' ability to reclaim their debts fully.

4.3. New Concerns

As a result of the extension of VAT to fee-based services, debt collection services, and short-term insurance services, new concerns have emerged. These concerns are not inherent to the taxation of financial services; rather, they have to do with the level of development of the financial industry in Ethiopia.

First, the new proclamation explicitly states that fee-based services provided by financial institutions are now subject to VAT.[89] This includes services delivered through digital platforms such as mobile banking, ATMs, and other online financial services. In theory, such an approach may benefit businesses as they will be able to recover their input VAT.[90] Nevertheless, it could have unintended consequences on customer behavior and the financial services sector as a whole.

Tax increases costs that may prompt bank customers who rely on digital services – such as mobile apps, online transfers, and ATMs – to reconsider and return to in-

[87] Value Added Tax Proclamation No. 1341/2024, Art. 42(1)
[88] *ibid*, Art. 42(4)
[89] Explanatory note, p. 8.
[90] Schenk A., Thuronyi V., Cui W., *supra note* 31, p. 368.

person banking. This shift could hinder digital transformation efforts aimed at enhancing financial inclusion and efficiency. [91] Financial institutions that have invested significantly in digital infrastructure may also experience lower returns if customer engagement with digital platforms declines. It has also been reported that not only banks but also other mobile money service providers may be affected by this tax. The Global System for Mobile Communications stated that

> "[b]y imposing VAT on these services, the cost of transactions may rise, leading to reduced usage by consumers who are highly price sensitive. This could slow down the adoption of mobile money as an affordable financial service, potentially reversing the gains in financial inclusion. Additionally, agents, who are critical to the mobile money infrastructure, may face reduced incentives to continue offering these services due to increased operating costs."[92]

Second, the introduction of VAT on certain bank services, which are typically provided free of charge, could severely undermine the availability of these services. Many private banks offer services such as information consolidation and wage payment processing at no cost to their customers as part of their strategy to attract clients and mobilise deposits. [93] These complimentary services play a crucial role in building customer loyalty and encouraging long-term relationships between banks and their clients. However, the imposition of VAT could discourage banks from continuing to provide these services for free, leading to discontinuance or passing

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[91] Tewodros Tassew and et al, *Leveraging E-payments for Financial Inclusion in Ethiopia*, World Bank Blogs, 15 March 2024 < https://blogs.worldbank.org/en/nasikiliza/leveraging-e-payments-financial-inclusion-ethiopia-afe-0324> last time accessed on September 17, 2024.

[92] Global System for Mobile Communications, *Driving Digital Transformation of the Economy in Ethiopia: Opportunities, Policy Reforms and the Role of Mobile*, October 2024, P. 45 < https://www.gsma.com/about-us/regions/sub-saharan-africa/wp-content/uploads/2024/10/GSMA_Ethiopia-Report_Oct-2024_v2-1.pdf> accessed on November 01, 2024.

[93] Interview with Muluken Asmare Muluneh, Manager of Financial Accounting at Wegagen Bank, Addis Ababa, on 15 September 2024.

the cost onto their customers, which could undermine their efforts to attract new business. This may also affect the competitiveness of local private banks, as the Ethiopian market may be taken by better-equipped big foreign banks that can provide these services without additional costs to customers.

Third, a few underlying financial operations are taxed under the new VAT proclamation. For example, issuing a bank guarantee in exchange for a commission is subject to tax. This is a conventional banking service; hence, it makes no sense to drop it from the definition of financial service in the proclamation.

Fourth, the proclamation's Annexe 2.2 (b) includes debt collection as one of the services subject to VAT tax, whereas VAT regulation Art. 53(4) (d) and the proclamation's explanatory note under 3.9 exempts debt collection from VAT.[94] As a result, there is some misunderstanding about which types of debt collection are subject to VAT. Is it all types of debt collection or only certain types? This issue was raised during a discussion between the Ethiopian Bankers Association and the Ministry of Finance, but no definitive solution was provided.

Finally, the imposition of VAT on short-term insurance services could significantly deter individuals from purchasing non-mandatory insurance policies.[95] By subjecting these services to VAT, the cost of premiums will rise, potentially discouraging many from opting for coverage. Insurance companies are already in the process of seeking the National Bank of Ethiopia to adjust their minimum rate premiums on motor insurance to account for inflation,[96] which will naturally lead to higher prices for insurance policies. When VAT is added to these already increased premiums, the overall cost of obtaining insurance will rise substantially.

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[94] Explanatory note, p. 7.

[95] Interview with Getu Melkie Tilahun, Director at Legal and Regulatory Affairs, Nyala Insurance S.C, Addis Ababa, on 15 September 2024; Interview with Michael Mesfin Agonafir, Legal Service Manager at Africa Insurance S.C, Addis Ababa, on 15 September 2024; Meareg Fisha, Legal Service Director at Lion Insurance S.C., Addis Ababa, on 16 September 2024.

[96] Interview with Michael Mesfin Agonafir, Legal Service Manager at Africa Insurance S.C, Addis Ababa, on 15 September 2024.

The resulting decline in insurance uptake could have broader consequences for the country. Insurance plays a critical role in managing risk, promoting financial security, and stabilising both individual and business operations in times of unexpected loss or damage. A decrease in the number of people purchasing short-term insurance could lead to higher out-of-pocket expenses for individuals and businesses when faced with accidents or unforeseen events, potentially increasing the financial burden on the public. Furthermore, a reduced number of insured individuals may weaken the insurance sector itself, reducing the industry's ability to pool risk and distribute costs effectively. This could also diminish the broader economic benefits associated with a robust insurance market, such as increased economic resilience and support for entrepreneurial activities. Therefore, while the intent of the tax may be to increase government revenue, it could inadvertently stifle the insurance market and weaken essential protections for individuals and businesses.

5. Concluding Remarks

The VAT reforms made through Proclamation No. 1341/2024 and Regulation No. 570/2025 will have a positive impact on increasing government revenue, responding to the changes in technology, and increasing the efficiency in enforcing VAT collection. However, as Bird and Zolt aptly stated, tax is not only a means to secure funds: it may "be viewed as a mechanism to prevent inflation by taking money away from the private sector in as efficient, equitable, and administratively inexpensive way as possible."[97] The VAT proclamation and regulation fail to address some of the critical challenges and lack clarity and fairness. This has resulted in opposition from certain segments of society, which may have an impact on the compliance and enforcement of the laws.

[97] Bird R. and Zolt E., *supra note* 18.

In this respect, this article highlights the embedded issues in VAT reform, including some of the emerging concerns and continuing old problems in the newly introduced VAT proclamation and regulation. The imposition of VAT on fee-based services, including financial technology services, could have a long-term negative effect on the development and modernisation of these technologies, as well as on the overall efficiency of financial institutions. Similarly, the introduction of VAT on short-term insurance services could discourage individuals from purchasing or maintaining insurance policies. A reduction in the use of insurance services could affect not only policyholders but also have broader consequences for the insurance industry and the country's economy. In addition, the lack of clarity regarding which types of debt collection are subject to VAT creates confusion and inconvenience for financial institutions and their clients. This ambiguity adds to the operational complexities and may result in inconsistent tax applications.

Moreover, the continued inclusion of foreclosure under VAT perpetuates pre-existing issues related to the valuation of foreclosed properties. Banks have faced challenges in recovering their full payments, as the VAT becomes part of the sale price of the property when transferred to third parties. Since the valuation method remains unchanged, this issue is likely to persist, hindering the ability of financial institutions to recover their full losses through foreclosure sales.

In relation to the VAT-inclusive/exclusive pricing, while the Federal Supreme Court Cassation Division has decided that the selling price is VAT-inclusive, the new proclamation has changed the wording of the previous law. It inserted an obligation on the seller to notify the buyer either orally, through the bid, or by any other means that the price is VAT inclusive. Such a change may preclude the application of the decision of the Cassation Division to future cases. Therefore, courts may not be bound to follow the previous decision, which continues the uncertainty that existed before the Cassation ruled on the matter.

These challenges highlight the need for ongoing refinement of the VAT regime to ensure legal certainty, administrative clarity, and also balance revenue generation with economic development and market stability.

Conflict of Interest

The authors declare no conflict of interest.