

# Effective tax rates in Ethiopia

ICTD-WIDER Workshop  
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# Background

- Low but increasing tax to GDP ratio in Ethiopia
- Corporate taxation: 20% of total tax revenue
  - 35% trade taxes, 35% direct, 30% indirect
- Relatively small manufacturing sector (5%)
- Investment promotion: fiscal incentives (CIT)
  - Foregone revenue VS increase competitiveness
  - Incentives for investment and export + others
- Growth and Transformation Plan 2 (2015-2020)
  - Stronger focus on industrialisation and manufacturing

# Objectives and data

- **ETR:** Tax as a ratio of income, a measure of tax burden on firms
- **Objective:** quantify the tax burden and analyse cross-firm differences
- **Motivation:** Increase revenue + promote industrial development
- **Two main hypotheses:**
  - HP1: Large firms may face a lower tax burden
    - Technical and political reasons
  - HP2: Smaller firms are less payment compliant
  - Plus: sectoral differences in ETR, losses, nil-filers
- **Data:** administrative data from corporate tax returns (CIT) 2012/13 and 2013/14
  - Potential + limitation (informal sector)

# ETR methodology

- Microeconomic VS. Macroeconomic data
- Backward looking VS. Forward looking
- Average VS. Marginal ETR
- 4 ETR measures:

		Numerator	
		Tax paid	Tax payable
Denominator	Taxable income	ETR 1a	ETR 1b
	Gross profit	ETR 2a	ETR 2b

Tax minimising strategies and use of tax benefits (HP1):

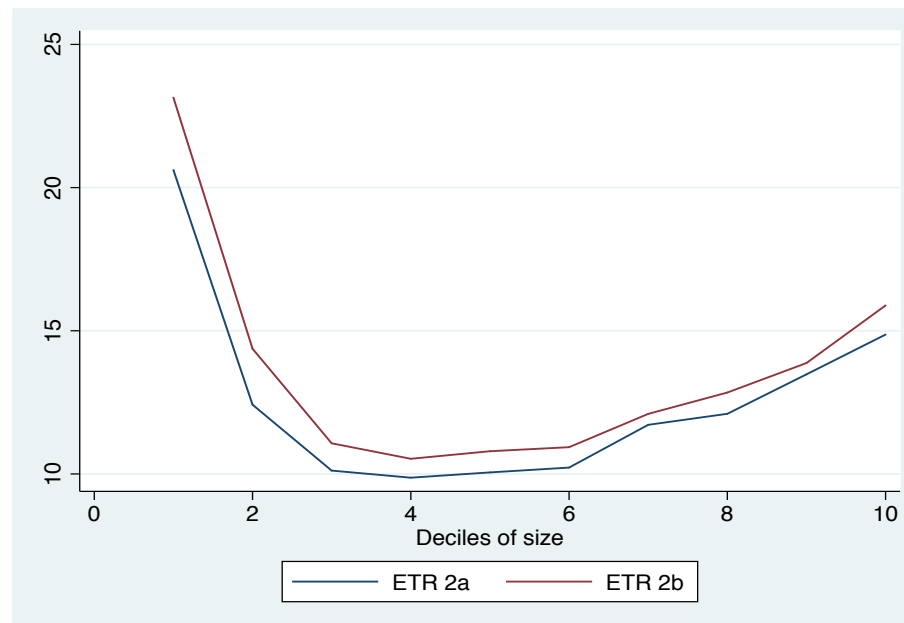
- ETR1a vs.ETR2a
- ETR1b vs.ETR2b

Payment compliance (HP2):

- ETR1a vs.ETR1b
- ETR2a vs.ETR2b

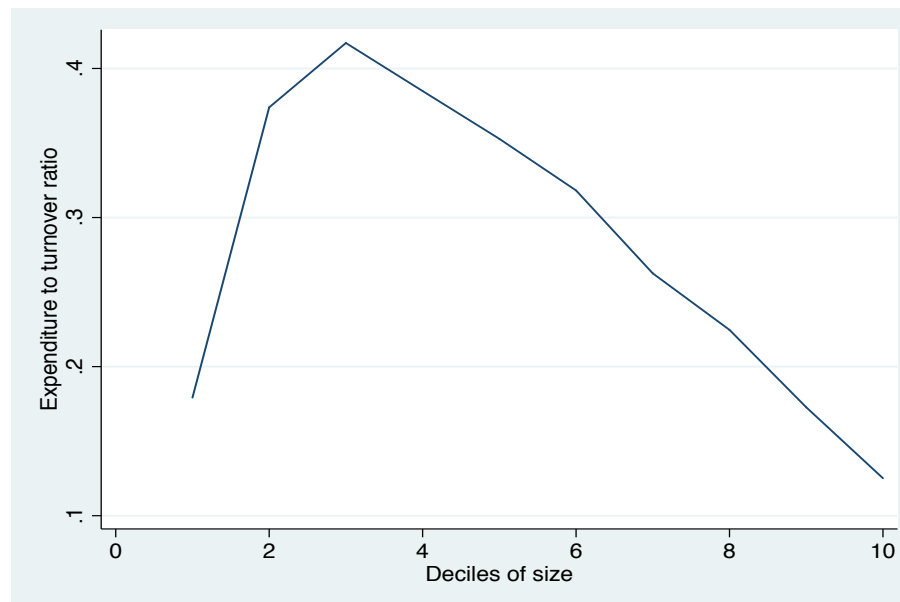
# HP1: Do large firms pay less?

- Small firms face the highest tax burden
  - Technical capacity, access to accountants, compliance costs
  - Bracket creep: small firms here
- Large firms pay less, but still more than medium-sized firms
  - Visibility, enforcement pressure (90% revenue from top decile)
- Medium sized firms benefit from the lowest tax burden
- Regression results confirm this result (sector, location, etc)



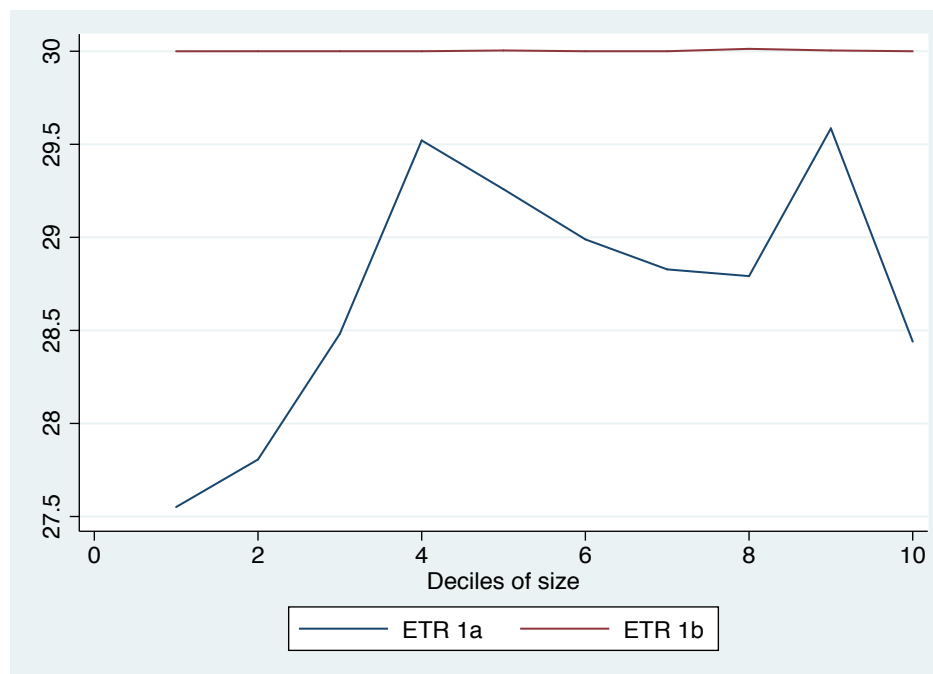
# How does that happen?

- Reverse U shape in the expenditure to turnover ratio
- Small firms: compliance costs
- Expenses are less verifiable by the tax authority
  - “Other expenses” about 20% of the total
  - Data quality and availability
  - Harder to cross-check across tax types
- Other possible explanations: lower investment?



## HP2: Are small firms less payment compliant?

- (Slightly) higher payment non-compliance for small firms
- Possible explanations:
  - Less use of withholding procedures for small firms (from data)
  - Less enforcement pressure: low revenue potential here
- Result weaker than previous



# Other 'descriptive' results

- High reliance on large taxpayers in the capital
  - Top decile generates 90% of total CIT revenue
  - About 90% of the sample in Addis Ababa (tax centre)
- Large proportion of firms reporting losses or 'nil-filers' (40%)
  - Registry issue?
  - Higher proportion in agriculture and amongst smaller firms
- Relatively higher tax burden in the manufacturing sector → structural transformation & industrial dev.?
- Expected negative coefficients on fixed assets and leverage (regression)

# Conclusions: main results

- Starting point, more research to be done
- Small firms:
  - Compliance costs, technical constraints, accounting requirements (thresholds)
  - Less payment compliant → but still this does not compensate
- Large firms:
  - Visibility, enforcement pressure on top taxpayers (capacity)
- Different result than other studies
  - Gauthier and Reinikka: higher tax burden on medium firms
- Others:
  - Higher burden in manufacturing sector, losses and ‘nil-filers’

# Conclusions: going forward

- Use of administrative data
  - Ethiopia is a pioneer, with Rwanda and South Africa
  - Data quality, feasibility, further data development
  - Sensitisation on the value of policy relevant research
- Involvement of policymakers and practitioners
  - Potential follow-on activities: expenses, withholding, registry
  - ‘Hands-on’ mutual capacity building
  - Support to evidence-based policy
- **Linking research to practice**

# Thank you